



Wiley Trading

# FOREX ON FIVE HOURS A WEEK

PAKISTAN VIRTUAL LIBRARY

[www.pdfbooksfree.pk](http://www.pdfbooksfree.pk)

HOW TO MAKE MONEY TRADING  
ON YOUR OWN TIME

## RAGHEE HORNER

EDITED BY JEFFREY ALAN BRANDZEL

---

# Forex on Five Hours a Week

---

*How to Make Money Trading  
on Your Own Time*



**RAGHEE HORNER**

*Edited by*

**JEFFREY ALAN BRANDZEL**



**WILEY**

John Wiley & Sons, Inc.

Copyright © 2010 by Superior Management, LLC, d/b/a In Touch Marketing, and Raghee Horner. All rights reserved.

Published by John Wiley & Sons, Inc., Hoboken, New Jersey.  
Published simultaneously in Canada.

No part of this publication may be reproduced, stored in a retrieval system, or transmitted in any form or by any means, electronic, mechanical, photocopying, recording, scanning, or otherwise, except as permitted under Section 107 or 108 of the 1976 United States Copyright Act, without either the prior written permission of the Publisher, or authorization through payment of the appropriate per-copy fee to the Copyright Clearance Center, Inc., 222 Rosewood Drive, Danvers, MA 01923, (978) 750-8400, fax (978) 646-8600, or on the web at [www.copyright.com](http://www.copyright.com). Requests to the Publisher for permission should be addressed to the Permissions Department, John Wiley & Sons, Inc., 111 River Street, Hoboken, NJ 07030, (201) 748-6011, fax (201) 748-6008, or online at <http://www.wiley.com/go/permissions>.

**Limit of Liability/Disclaimer of Warranty:** While the publisher and author have used their best efforts in preparing this book, they make no representations or warranties with respect to the accuracy or completeness of the contents of this book and specifically disclaim any implied warranties of merchantability or fitness for a particular purpose. No warranty may be created or extended by sales representatives or written sales materials. The advice and strategies contained herein may not be suitable for your situation. You should consult with a professional where appropriate. Neither the publisher nor author shall be liable for any loss of profit or any other commercial damages, including but not limited to special, incidental, consequential, or other damages.

For general information on our other products and services or for technical support, please contact our Customer Care Department within the United States at (800) 762-2974, outside the United States at (317) 572-3993 or fax (317) 572-4002.

Wiley also publishes its books in a variety of electronic formats. Some content that appears in print may not be available in electronic books. For more information about Wiley products, visit our web site at [www.wiley.com](http://www.wiley.com).

***Library of Congress Cataloging in Publication Data:***

Horner, Raghee.

Forex on five hours a week: how to make money trading on your own time / Raghee Horner.

p. cm. – (Wiley trading series)

Includes index.

ISBN 978-0-470-43643-1 (cloth)

1. Foreign exchange market. 2. Foreign exchange futures. 3. Speculation. I. Title.  
HG3851.H668 2010  
332.4'5–dc22

2009044762

Printed in the United States of America.

10 9 8 7 6 5 4 3 2 1

# Contents

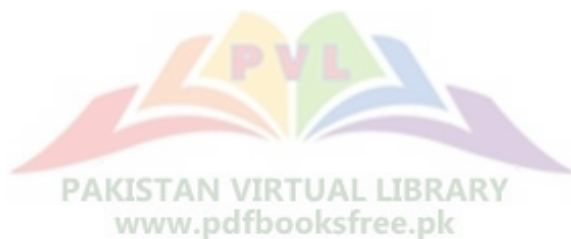
<b>Preface</b>	<b>vii</b>
<b>Acknowledgments</b>	<b>xi</b>
<b>CHAPTER 1     Making Money in Up and Down Markets</b>	<b>1</b>
<b>Fill in the Blanks</b>	<b>2</b>
<b>A Bull Is on the Loose!</b>	<b>3</b>
<b>Shorting</b>	<b>4</b>
<b>CHAPTER 2     Full-Time Trading = Full-Time Job</b>	<b>9</b>
<b>Employee Mindset</b>	<b>11</b>
<b>Confessions of a Chart Junkie</b>	<b>12</b>
<b>Analyzing the Market</b>	<b>14</b>
<b>Identify the Trend</b>	<b>16</b>
<b>Time Frames</b>	<b>16</b>
<b>CHAPTER 3     The Wave</b>	<b>19</b>
<b>Sinking, Soaring, or Sideways?</b>	<b>23</b>
<b>Market Cycles</b>	<b>23</b>
<b>A Wish</b>	<b>28</b>
<b>Market Memory</b>	<b>28</b>
<b>Trade with Price</b>	<b>31</b>



<b>CHAPTER 4</b>	<b>Objectivity</b>	<b>33</b>
<hr/>		
Indicators		34
Order Entry		35
Stop Loss		36
Risk Management		38
Trendlines, Support, and Resistance		41
Static and Dynamic Lines		41
<b>CHAPTER 5</b>	<b>The Magic of Lazy Days Lines</b>	<b>43</b>
<hr/>		
Fibonacci Analysis		44
Lazy Days Lines at Work		45
Using Lazy Days Lines		46
The Wave in Action		48
Real-Life Lazy Days Lines		54
Comprehension + Confirmation = Confidence		55
<b>CHAPTER 6</b>	<b>The Only Entries You Need</b>	<b>57</b>
<hr/>		
Momentum Trading		58
Swing Trading		63
Short Cycle Set-Ups		68
Inside the Range		71
<b>CHAPTER 7</b>	<b>Around the World</b>	<b>73</b>
<hr/>		
Who's Awake?		74
Financial Centers You Need to Know		75
Prime Time!		76
Pip Movement		81
A Day with the EUR/USD		82
Time Out!		85
Choosing Your Trading Time		95

<b>CHAPTER 8</b>	<b>Market Pulse</b>	<b>97</b>
<hr/>		
U.S. Dollar Index and USD/CAD		104
U.S. Dollar Index and AUD/USD		110
<b>CHAPTER 9</b>	<b>Trading Psychology</b>	<b>117</b>
<hr/>		
Stay in Balance		119
The Role of Experience		120
Trading for Real		123
The Psychology of Market Cycles		125
The Psychology of News		125
The Psychology of Time		127
The Psychology of Numbers, Entries, and Exits		128
<b>CHAPTER 10</b>	<b>Psychological Numbers</b>	<b>131</b>
<hr/>		
Using the Herd		133
The 200 SMA		133
52-Week Highs and Lows		135
<b>CHAPTER 11</b>	<b>Trading Edge</b>	<b>137</b>
<hr/>		
The Right Side of the Chart		145
Consumer Confidence		146
Risk Appetite		148
Sell the News		148
<b>CHAPTER 12</b>	<b>Is My Broker Friend or Foe?</b>	<b>153</b>
<hr/>		
The 2 Percent Question		155
Stop Loss Placement		156
Triage		158
Trading Truths		158

<b>CHAPTER 13 Embracing Automation</b>	<b>163</b>
<b>Charting Tools</b>	<b>166</b>
<b>Profit Targets</b>	<b>166</b>
<b>Fifteen-Minute Set-Ups</b>	<b>170</b>
<b>CHAPTER 14 Raghee Recommends</b>	<b>179</b>
<b>Final Thoughts</b>	<b>183</b>
<b>Index</b>	<b>187</b>



# Preface

*Forex on Five Hours a Week* is about having a life! But more than that, it's about challenging assumptions. Somewhere along the line, we were taught that for something to be effective means it must be time consuming. We've mistaken time spent for effectiveness. If we decided to buck the trend, it's dismissed as laziness, akin to looking for a shortcut. This attitude comes from an employee mindset. I've been an employee for a total of 22 months of my adult life. I don't say this to brag. I'm quite unemployable, as my luck would have it. Consequently, I was basically shoehorned into figuring out how to make a living without clocking in and collecting a paycheck each week.

I am not going to bore you with all the details as to how I discovered I could make a living trading the markets. The bottom line is that along the way, making every rookie mistake that could be made (twice), I learned that the markets are just an extension of human behavior and nothing nearly as sophisticated or complicated as Wall Street would have Main Street believe.

I've been lucky enough to be able to share with you what I do each day, and I don't take this privilege for granted. As I have traveled the globe teaching and talking about the markets, it dawned on me that far too many traders and would-be traders were addicted. They're market junkies. I've heard stories about traders who arise in the early hours of the morning to trade; traders who have laptops in their bathrooms; traders who spend upwards of 16 hours a day analyzing charts and creating systems. I'm not going to belabor all the stories I've been told, but trust me, the list goes on and on, and, frankly, they get stranger and stranger. Is this what trading is, an addiction?

If more time spent trading and analyzing yielded better results, heck, I would do it. But it doesn't. Bottom line is that just as many traders stink today as they did 20, 30, 50 years ago, and there are more traders in the markets now than ever before. Present-day traders have sophisticated equipment, unprecedented access to data, order flow, and transparent order

entry. I'm smiling right now as I think back when I began as a high school student with paper chart, ruler, and pen.

While a teenager, in my initial trading stage, I realized I was a part-time trader. And in reality, so are most traders. If we wanted a job, I'm sure there are easier ways to make a living and not put ourselves through the meat grinder of being a trader. If you're reading this because you think it will be easy, kindly close this book and put it back from where you found it. But let me say, it ain't hard!

So what exactly is *Forex on Five Hours a Week*? It's about understanding that more is not better. Better is better. *Forex on Five Hours a Week* will show you how to analyze the market, how to use visual and objective tools, and then formulize a plan to trade successfully. This is not daytrading, which I don't do. This is not investing, although many of the strategies in this book could help you with that facet of your portfolio. This is about grasping a few concepts that if properly understood and applied, can yield healthy and consistent returns.

The forex market offers the best order entry, leverage, and access of any market. This market is available 24 hours a day and can most likely fit your schedule. This is not about being a full-time trader. My goal is to allow you to fit trading into your current schedule. That means quick, accurate analysis that you can repeat over and over again.

This book is as much a written text as it is a complete course. I've included links and charting examples, which allow me to walk you through the concepts in this book. I'm especially happy about that because this makes it easier for me to show you additional examples of the strategies I use, such as working across multiple time frames and pairs. I also invite you to join me at my blog at [ragheehorner.com](http://ragheehorner.com) where I discuss the markets on a daily basis and share videos and color charts of set-ups and price action that I am watching. It's just another way of keeping in touch after you complete this book.

The *Forex on Five Hours a Week* approach is as much about streamlining your market analysis as it is about challenging assumptions. There are going to be ideas that I will share with you that challenge the norm and perhaps are 180 degrees from what you have heard or even have been doing! This does not stem from some desire of mine to zig when everyone else is zagging.

I share and examine in this book the two types of thinking that you must consider before making a trade: internal psychology and external psychology. I will cover my  $C + C = C$  approach to psychology as well as other trading psychology. But I want you to keep this thought in mind: Most traders fail, yet most traders do more or less of the same thing.

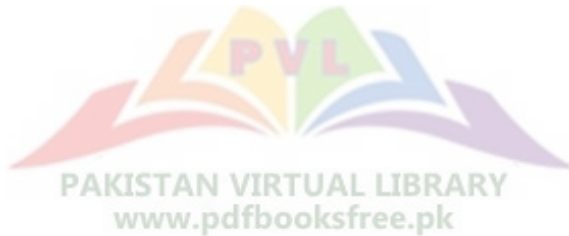
They continue to seek out the most popular, most used, most known tactics and tools. Why? Is there safety in numbers? Not in this case. If you

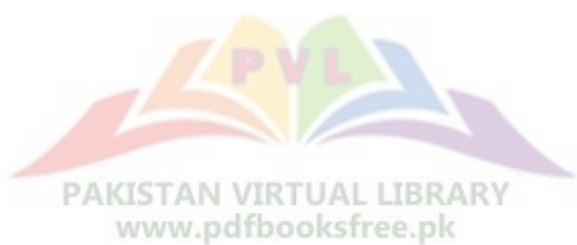
are with the majority in this game, you're losing. So, if you find that most traders are doing things a certain way, whether that be trade management, entries, risk management, whatever . . . then you probably don't want to do it the same way. I often adhere to my 90 percent rule, which put simply says, "If everyone is doing it, it's probably wrong."

*Forex on Five Hours a Week* readers will use the psychology of the market to their advantage; after all, that is what you are tracking, analyzing, and watching on a price chart. This is external psychology. Never forget that you are trading reactions, fear, greed, and uncertainty. This alone will take you past the charts and make trading a much more natural activity. And that's when you will find that trading is just a natural extension of human nature.

Yours in Trading,

Raghee Horner





# Acknowledgments

I finished writing this, my third book, today, and I can't help but be grateful and think back on the series of coincidences and the people who got me here. I am lucky to be surrounded by a family who supports me, friends that make me smile, and partners that demand the best of me. And most of all the students who push me to be better and whom I always hope to be better for. You inspire me every day and make teaching a joy. I am a better trader and person today, and I can't help but think that you all have a little something to do with that.

Success is just a series of coincidences that we can seldom see coming but must be ready for regardless...and that seems to be the inside joke of life.

To the love of my life, Herbie, who knows that love doesn't mean doing everything for me but making me feel that I can do anything. Thanks for believing in me when I have doubts, holding my hand when I lose my step, and knowing when to let me run. There isn't a day you don't make me feel loved.

To my sister, Nila, the smartest, funniest, bravest, most generous, and most beautiful human being in my life. I don't know what I ever did to deserve you, but it must have been grand. You are my hero, my confidante, and the best reason I can think of that the world is a good place.

To my Ma, who gave me the best two gifts ever: life and my little sister. You have always been all my reasons, Mama.

I never feel alone when I am tackling new projects, and it's the people whom I have been fortunate enough to meet and call friends who allow me to keep doing what I love to do.

To my partners Dale, Sasson, Brenda, Victoria, and Jeffrey, the team behind the success of Raghee.com. You all never give up on me and have the patience of saints. Thank you for your support and may we continue to find success as a team!

To David Pugh, my editor at John Wiley & Sons. Thanks for your trust, brainstorming sessions, and support. Most of all, thanks for letting me take yet another whack at this.



To my good friend, Marilyn McDonald. You are not only brilliant but most importantly a good person whom I am lucky to call friend. Year after year I continue to be amazed by the ideas you come up with and the integrity with which you execute them.

To my genius friends at Autochartist, Erik Voges and Ilan Azbel. I am honored to work with you both. You two are about two feet smarter than I am! I love the ways your minds work. You have created and improved upon one of my favorite pieces of software, and your PowerStats keep me playing the game at the right time. And special thanks to Yvette and Marita for your daily assistance and support.

Speaking of geniuses, I have to thank Chris Kryza of Divergence Software. You changed my trading for the better and continue to help me find ways I can streamline and optimize my trading. And you do it better than anyone, my friend! Thank you for all the help throughout the years.

And how can I forget my Facebook buddy, Jimmy Jones? Thanks for my GRaB plug-in upgrade! Truly above and beyond!

The Internet has made the world smaller and information available to more people, and, even better, it has allowed more people to get involved and share their two cents' worth. I have to mention a few sites here that I not only contribute to but also use day to day and thank them for the great information they provide.

To the staff at BabyPips.com, can I just say that I am a huge Queen Cleopatra fan? Brilliant! Thanks for the support and for emphasizing that learning to trade can be fun.

To Trading Markets and Eddie Kwong, who were the first people to publish my articles online long before the books and seminars, you allowed me to share my ideas, and look where it took me! Thank you.

To eSignal. I don't take my charting lightly, and you guys are my pipeline to the markets and have been for over a decade. I cannot tell you how it floored me when you included my name on the Trading with the Masters page! Sometimes I still don't know what I am doing up there, but I must admit, I love it. Special thanks to Scott Wilks, my eSignal rep for all these years.

To Francisc, Maud, and Noemi at FXStreet. Thank you for letting me share my ideas at the site with my chats and Chartology blog. I want to add that the Fibo and Pip comic strips were generously contributed from the good folks at FXStreet and Fibo and Pip creator, Josep Giro.

To Tim Bourquin. It seems like a million years ago, but Tim, that interview for TraderInterviews.com was the first I ever gave and that's something I will never forget. I look forward to the Forex and Traders Expo talks each year. Thanks, buddy!

To the International Securities Exchange (ISE) and Steve Meizinger, whom I love talking options with and who has single-handedly taught me

more about options than I ever thought I would be able to absorb in this lifetime . . . and made it fun! I love presenting for the ISE and appreciate the opportunity.

As I tend to do from time to time, I worry my editor David and my partner Sasson, as they get a bit concerned with me because of my loose relationship with the concept of a deadline. I'm getting better, aren't I? As always, there's nothing a cattle prod cannot solve. So in this case, I think I have to thank some people who didn't necessarily even know they were a help in writing this book, or rather getting this book done and out the door!

To Tim Salem, aka CVJ. I have enjoyed our chats and e-mails. You were able to give me so much valuable insight into what I can offer traders and how I can do it better. Thanks for your honesty.

To Sam and Cole Flournoy. I know I'll be reading about all the great things the two of you will be doing very, very soon! You both inspire so much with your smarts and drive. I am lucky to know both of you. I must say here and now that everyone who has an iPhone should have the Forex on the Go app!

To one of my best friends, Pam Curry. There's nothing like having a girlfriend to complain to and a house to hide from the world at. You're a force of nature, and mom to three of my favorite kids on the planet. Whenever I was feeling a little lazy and unfocused, I thought of you and all that you squeeze into 24 hours and promptly went back to work. I'm in awe of all you do, my friend. You make it look easy.

To my dearest and closest friend, Melissa Young Orndorff. You never make friends again like the ones you made when you were 12. You make me smile and laugh out loud no matter what is going on around me. In all my life I'll never find another *you*: You're an angel. I don't know what I would do without you. And, of course, I have to give a shout-out to Mr. Peeps!

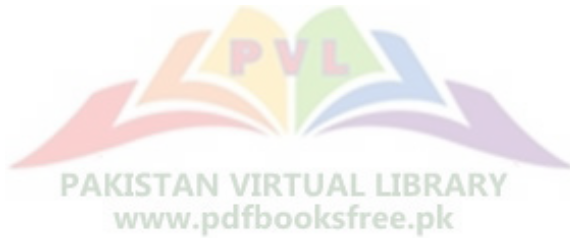
To Anna Dupras. Ups and downs, no doubt. Laughter always. No matter what, I can't say enough how proud of you I am.

To my cousin, Bobby Choudhuri, who has been the example and the inspiration for more than I can even explain. You've always encouraged me, and better than that, you were the example. You're one of my best teachers, Dada.

To my Dad. I lost you when I was 15, but the older I get I think I finally get it. It took me a while to realize that you never really left but became the promise and hope that guided me. You came from nothing and gave everything. Your girls, your "pride" and your "joy," hope that we've made you proud.

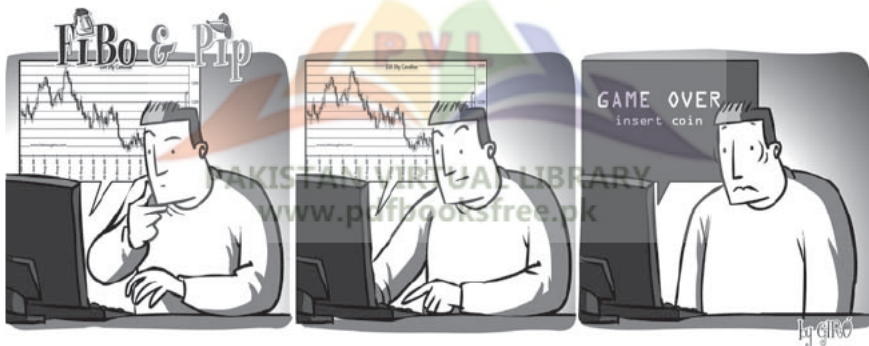
And finally, to old friends, whom I've never forgotten, and the memories that make me smile and no doubt make me the person I am today. As

kids we just don't know where we're going. We're living for recess and a good snack in our lunch bag. One day rolls into another and the years go by so slowly. Then all of sudden 10, 15 years have flown by, and then you wonder where all your buddies went, because you didn't stop to see what road they were heading down. It happens. But not long after, it seems everyone's on the same road again. That's the cool part. Thank God for Facebook! Hey there, Paul Washburn! We gotta sit down and listen to some records, buddy!



## CHAPTER 1

# Making Money in Up and Down Markets



**Learn the rules or the game is over before it started.**

2006 "Fxstreet.com. The Forex Market." All Rights Reserved.

People like to buy. That seems to simply be a fact of human behavior. One of the things that most traders and investors look for are markets that are heading up and will continue going higher. I can no more tell the future than anyone on Wall Street, and my guess is that your crystal ball is at the repair shop as well. So what can we do? Given the widespread preference for buying, the best thing to do is find a market where you can find a bull market no matter what. That's the forex market.

This is where the U.S. dollar comes in. The six most popular pairs in the forex market are either U.S. dollar-correlated majors or U.S. dollar-based

commodity currencies also known as “comm dolls.” You didn’t think I was going to let you sound like a newbie now, did you?

Let’s briefly discuss the difference. U.S. dollar–correlated majors are the euro/U.S. dollar, the U.S. dollar/Japanese yen, the British pound/U.S. dollar, and the U.S. dollar/Swiss franc. The four pairs trade against the U.S. dollar. The reason these are “correlated” is that the movements of these pairs have a strong relationship to the U.S. dollar, which we can track with the U.S. dollar Index. We’ll talk in the next section about the relationships in detail, but for now keep in mind that the forex is a game of comparison. Is the U.S. dollar gaining or losing ground to another nation’s currency?

If it seems as though I am spending an inordinate amount of time driving this point home it is because I think far too many traders forget that trading forex is a very tangible thing. It personally affects our everyday lives and the everyday finances of corporations and banks. Our world and collective economies are not isolated, and the global economy is now more intertwined than ever. Anyone who for a moment bought into the theory that somehow the U.S. economy was dislocated from Europe, Asia, and the BRIC countries (Brazil, Russia, India, China) should now know different after witnessing a cataclysmic global slowdown. My point here is that forex, the relationship between different currencies, is at the heart of the worldwide financial system and the more you understand this relationship the better overall trader you will become. Now who said forex trading couldn’t make you a better person?

PAKISTAN VIRTUAL LIBRARY  
[www.pdfbooksfree.pk](http://www.pdfbooksfree.pk)

## FILL IN THE BLANKS

---

In case you’re new to forex, here’s the one line synopsis of what the foreign exchange market is: How many \_\_\_ will I get for \_\_\_?

How many *yen* will I get per U.S. *dollar*?

How many U.S. *dollars* will I get per *euro*?

So basically depending upon the strength or weakness of the U.S. dollar you may be able to get more or less of another currency in exchange. I think of it as the airport analogy. Let’s say we all jump on a flight to Paris and upon landing we look to exchange our pocketful of U.S. dollars for euros. The forex rate will dictate what we get.

Traders and investors track, analyze, and use this price movement to determine whether they feel this rate will go higher or lower.

That brings us to commodity currencies or “comm dolls.” Maybe you have heard a little about what these pairs are and how they behave. My

take is a little different, so let's start with the basics. Generally speaking, commodity currencies are just what their name would suggest: a currency pair that has a strong correlation back to a particular commodity. Simple, right? Well, not so fast.

The Australian dollar/U.S. dollar, New Zealand dollar/U.S. dollar, and U.S. dollar/Canadian dollar are the three pairs you will most commonly call "comm dolls." Let's use the U.S. dollar/Canadian dollar or "canada" as an example. The "canada" has a relationship to the energies complex, meaning crude oil, heating oil, natural gas. It moves, however, with a strong correlation to crude oil. Why? Well, consider that the country of Canada is one of the world's leading exporters of crude oil (from [www.eia.doe.gov/pub/oil\\_gas/petroleum/data\\_publications/company\\_level\\_imports/current/import.html](http://www.eia.doe.gov/pub/oil_gas/petroleum/data_publications/company_level_imports/current/import.html)).

You better bet the supply and demand of crude affects the Canadian economy. But is that the end of the story for commodity currencies? No, not even close. You see this pair has a correlation to the U.S. dollar as well. Remember it's the U.S. dollar/Canadian dollar pair. We not only have to consider the impact of crude oil on the Canadian dollar itself but also how the U.S. dollar is moving against the Canadian dollar.

I am going to go into great depth later on about these relationships and my Forex Market Pulse. For now, though, think about this: Does crude oil affect the Canadian economy alone? I think we have seen what high crude oil prices have done to the U.S. economy as well. So bottom line? All pairs that have a relationship back to the U.S. dollar will have a certain amount of impact from crude oil. And that means that all U.S. dollar pairs can be considered comm dolls to a certain extent. Now that's not something you will hear from most traders, but I'm here to tell you that's the way it is.

So, there's always a bull market somewhere in the forex. When you consider all the different countries, commodities, and the relationship they have with one another, it's easy to begin to understand that while some currencies are being beaten down, others are rallying in comparison or are considered safe haven currencies. This is why you will always find that some pairs are heading lower while others are ripe for buying.

## **A BULL IS ON THE LOOSE!**

One of the more appealing aspects of the forex market, beyond the 24-hour always open trading, is the fact that there's always a bull market somewhere amongst the pairs. The idea of buying a stock or futures contract or a forex pair is much more familiar to most people, especially since most of us are already familiar with investing. Investing and trading do have two



completely different mindsets. For investors, the whole idea is ownership: to own more shares of a company or mutual fund or even ETF (electronically traded funds). Most people incorrectly believe that trading is buying low and selling high . . . wrong! That is actually investing. Now, of course, investors do hope that their holding will increase in value, but that is secondary to ownership.

Traders don't own anything; in fact, they don't want to because the goal in trading is to profit from price movement. Instead of owning, traders control shares, contracts, lots, or pairs with leverage. Now what does all this have to do with playing U.S. dollar strength or weakness? Traders understand that in order to profit from price movement they must buy and short. That's right, "short." After all, trading means making money in up and down markets. If you were only to play one side of the market you would consistently miss opportunities to benefit from when the U.S. dollar moves a pair lower.

Consider this move. The U.S. dollar gains strength on the euro. The resulting move on the chart would be weakness, a sell-off and even a downtrend in the EUR/USD (euro/U.S. dollar). In order to profit from this relationship a trader would have to short or sell the EUR/USD. Here's another example, one that has hit closer to home for most people. Crude oil has been on a rollercoaster as of late, reaching new highs and selling off to significant lows. In fact, over the course of less than six months, crude oil has moved over \$100. Crude oil has a strong correlation to the commodity currency of the U.S. dollar/Canadian dollar (USD/CAD). The USD/CAD is affected by U.S. dollar movement but as with all forex analysis, you must consider the other side of the pair, in this case the Canadian dollar. The Canadian dollar or "loonie" is affected by crude oil prices because Canada is a huge exporter of oil. When oil strengthens, this helps the loonie strengthen. If oil weakens, it can take the loonie down with it. So as the crude oil market sells off, the loonie has been weakening against the U.S. dollar, which results in a downtrend on the chart of the USD/CAD. The only way to benefit from that movement in the forex would be to short the USD/CAD and profit from the weakness.

## SHORTING

The real value in trading has always been the fact that traders can profit in both up and down markets. This has always been one of those ideas that people have a hard time wrapping their brains around. Even though I spent a good deal of time telling you that you can always find a bull market in forex, that's not where I want you to stop looking for opportunities. I'll let

you in on a little secret. Gravity applies to the markets too. Prices always fall quicker than they rise. It's a function of fear and panic. And, yes, you can profit from it. But before you think of me as some heartless trader preying upon fear, remember that trading and investing must have participants willing to sell. I'm not sure where this concept blipped off the radar, but it's one that the general public doesn't seem to get: For every buy there is a sell. The reason prices move higher or lower is based upon where the transaction takes place. However, there still must be a buyer and seller willing to do a deal in order for a trade to take place.

Let's discuss it in terms that most people can visualize, the housing market. When a house goes up for sale you have a seller, that's the current homeowner. This homeowner is hoping that there is demand—and lots of it! More demand for the house, and the price at which they can sell (think of it as where the trade will be done at) will be higher. Less demand, and the price at which they will likely sell will be lower. The stock, futures, and forex markets work the same way. When there are plenty of homes for sale and not as many buyers, that's a buyer's market. If you were to plot that on a chart, the trend for home prices would be down. Now take that same scenario and apply it to a stock. Let's use IBM. If IBM came out with a bad earnings report, or if a new product line flopped, or a problem was found in server design—any one of the myriad of issues that can hurt a company and a stock—the value of IBM would likely go lower over concern for what these issues mean to IBM sales and profits. What if you could profit from prices heading lower? We all know we can profit from prices moving higher as good news is discounting into a stock and both traders and investors buy in expectation of more success, profits, and sales from IBM. But what if events go the other way?

I'm going to warn you that you may need to reread this until you get the mechanics of what I am going to explain implanted in your mind. It may take some time to click, but once it does, it's going to open a whole new world to you and your trading opportunities. I remember the first time I was introduced to the concept of shorting. It was foreign and took me a week to understand. Conceptually it made sense, but it wasn't until I understood order flow that it made total sense. I began to see why it was such an important concept and a viable position to take in a downtrending market. Funny enough, I actually thought for a short while that it was illegal until my broker walked me through what I am about to explain to you. Remember that while you read this, until people are willing to sell and short the market as we know it, it would not exist. I'm not trying to be dramatic, it's just plain fact.

I could just say that when you are shorting a market (stocks, futures, or forex) you're selling it at a higher price and buying it back at what you hope to be a lower price for a profit. But selling something you don't own doesn't



necessarily make sense, does it? And for those of you who are already familiar with shorting, I am probably preaching to the choir, but come along for the ride here regardless. You may find out a few things about order flow you didn't know before.

I am going to use a stock example again, because time and teaching literally thousands of traders has taught me that using this as a frame of reference seems to be one that most people feel comfortable with, and the mechanics apply to any market. Let's take our old friend IBM again. Big Blue is heading lower, and as a trader you understand that one of your options would be to take a short position in IBM with hopes that it will head lower still from your selling price. How, who, and why?

The how of shorting is basically a process by which your brokerage will allow you to borrow shares of IBM. So that's where you get the stock to sell: You are getting it, borrowing it, from your broker! Next is taking these borrowed shares of IBM and selling them into the market. Who will buy it from you? The markets are divided into two groups, buyers and sellers, also known as the bid and ask, respectively. Buyers bid on a stock they want to buy and like all buyers they would like to pay as little as possible. The ask, or sellers, are on the other side. They own what the buyers want, and of course they would like to sell it for as high a price as they can get. How much they will get for it depends upon whether it's a buyer's or seller's market, just like real estate.

Imagine two lines of traders, one of buyers and one of sellers. These two groups are lined up by placing the bidder or buyer who is willing to pay the most for IBM at the front of the "buyer's line" and the seller who is willing to sell for the least amount at the front of the "seller's line." The difference between the highest bid and the lowest ask is the spread. Starting to make sense?

At the front of each line are the two participants that are closest to being able to get a deal done. So who gets their price? Well, that's determined by the overall direction of the market. The seller will have the advantage if prices are heading higher (more demand) while the buyer will have the advantage if prices are heading lower (more supply). In the trading world this balance can go back and forth from moment to moment. Since we are talking about shorting, we'll assume that the overall market psychology is bearish. This means that the overall direction of the market is heading lower and that the buyers are able to have their way, which means that the trades are generally being done at lower prices.

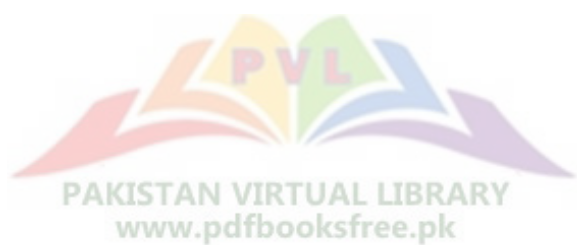
So since you are shorting and you have your borrowed shares of IBM, you are on the ask or "seller's line." You have a price that you would like to sell these shares for, and your hope is that you can find a buyer and that prices will head lower after you sell your shares.

So how do you profit from such a position, and why would anyone buy it from you? The first part is easy. Since you borrowed the shares from your broker, all the broker expects is that you return the shares to them. It's much like borrowing a book from the library. The library made you get a card so you are "approved" to borrow a book, and they expect you to return it. The broker in this case is typically going to let you have those shares borrowed out for pretty much as long as you need them. When you sold IBM, you collected a certain price per share from the buyer knowing that at some point you are going to need to buy some IBM sooner or later to return what you borrowed. Let me say that again, because here is often where the wheels fall off the wagon for a lot of folks.

You sold your borrowed shares of IBM into the market, and the buyer of those shares gave you, for sake of keeping this simple, \$100 per share. Now you have this \$100 per share, and that's half the equation here of this short position. Now based on your analysis you think that prices should head lower, and by golly, they do! \$98 ... \$93 ... \$88 ... \$87 ... \$84 ... until they level off at your target of \$80. So you sold at \$100 and prices sold off to \$80—a \$20 difference. Remember, your broker wants their shares back at some point, and you've decided today's the day and \$80 is the price. So you execute another order. Your first order was a SELL. Your second order is a BUY. This will allow you to realize the \$20 profit and return the shares of IBM back to your broker, thus closing out your short position. You sold these shares at 100 and are buying them back at 80, so the difference is yours.

I had also mentioned the "Why?" Why would someone buy these shares from you? Well, that's what is so wonderful about the markets. There are always going to be contrary opinions. Without them there would be no market. When I think I see a buying opportunity, there is someone out there who thinks that I am out of my mind and that there is a selling opportunity. Without both sides of the equation, buyers and sellers, there would be no market; there would be no investing, no trading, nothing! So next time you hear about someone shorting the market, remember, there had to be a buyer for that trade to be done and without both types of market participants there would be no liquidity. We'll talk later about liquidity and how the forex is the most liquid market on the planet and why that's so important to us as traders. For now though, I hope your mind is starting to see the opportunity in playing both sides of the market.

And by the way, my shorting example of IBM has nothing to do with anything happening in the market. I have been an investor in IBM for many years. It is the first stock I ever owned. My father, a proud IBMer, worked for them until the day he passed away.



## CHAPTER 2

# Full-Time Trading = Full-Time Job



**Perspective my friends, keep your trading in perspective!**

2007 "Fxstreet.com. The Forex Market." All Rights Reserved.

I don't know about you, but I have never wanted to work on Wall Street, or in an exchange, or for a bank, or be a fund manager, or manage other people's money for that matter (by the way, I tried it and hated it). That's not to say those are not important or fulfilling jobs. It's just that I have never been much of an employee. I've always wanted to work for myself, and that really is just my way of saying I want to dictate when and how hard I work. You're probably not that different from me. Who doesn't want that freedom? That's what trading is to me, freedom. There are plenty of ways to make a good living in this world. But I can't throw a

90 mile-an-hour fast ball, I can't sing or dance, and I always kick myself for not thinking of putting bird seed in a balloon and selling it as a stress relieving grip ball. Oh well.

*So it ain't just the money!* Trust me when I tell you that trading is the hardest way to make an easy living I can think of.

I am a part-time trader. I think that people who are employed as traders are professional traders or full-time traders, but there goes your freedom out the window. I have never been great at answering to anyone as my mother will attest. And I do like to sleep in from time to time, as a few of my friends will attest when they have called me in the morning only to wake me up!

So really by that definition I am a part-time trader and darn proud of it. Does that mean that I treat my trading as a hobby? Definitely not! But consider that forex, which is the main topic of this book, is a 24-hour market. I don't know about you, but I like to sleep, cook, train, golf, play a little Wii, read a book, maybe write a book, talk with friends, do a little blogging, dive, ride my motorcycle, go out to lunch with friends, go fishing, travel, you know, have a life! So obviously there are going to be times that I can't be in front of my computer and more often, don't want to be!

Let me tell you now that I was not always so enlightened. When I first started getting into trading, I was totally addicted. Addicted to the action, the charting, getting my hands on everything and anything trading related, and going at it 16 hours a day. No joke. And I'll tell you the whole tale later, but suffice to say, I'm a chart junkie. My trading wasn't better with my eyes glued to dual monitors. My friendships weren't better, and I'm pretty sure my husband thought I had lost my mind. Although he still might be holding that opinion.

So I eventually unplugged and embraced the life of a part-time trader. You can and should do the same.

There are a few things that will make it clear once you understand them. Just a few simple things are all you are going to need. I will show you how to use time frames to your advantage as well as the prime trading times for each pair. I'm going to lay it all out for you.

The forex is a 24-hour market, so do full-time traders ever sleep?

Okay, so now you may be thinking, "Raghee, won't I miss trades if I only watch the market part-time?"

And I will answer, "Yeah. You, me, and everyone else."

Even full-time traders have to sleep, eat, and well . . . you know. And believe me when I tell you that I have known quite a few traders with computers in the restroom. So trading forex is all about picking your spots and knowing when the market is most likely to move. This luckily is not completely unpredictable. Markets, like people, have a natural daily rhythm. As a trader, I count on it. In many ways, trading forex is trading the

opinions of seven different financial centers: Sydney, Tokyo, Hong Kong, Singapore, Frankfurt, London, and New York. These seven represent the major financial centers around the world, and each has its own psychology, volatility, liquidity, and rhythm. You can find a time to trade. It's really going to be more a function of your personal schedule. I will tell you though that all financial centers are not equal. Some are more important (New York) and larger (London) than others. Since the six most traded pairs are U.S. dollar-correlated (they reflect strength or weakness versus the greenback)—EUR/USD, USD/JPY, GBP/USD, USD/CHF, USD/CAD, AUD/USD—the “best” trading time is the overlap between Frankfurt, London, and New York which makes the forex “prime time” 7 A.M. EST to noon EST. What if you can't be in front of your computer then? I'll show you how to trade it anyway, and that goes for any financial center. With proper and well-thought out order entry and a firm grasp of time frames you can handle just about any market.

Just accept it now; you are going to miss the occasional trade. The sooner you can come to terms with that fact the less likely you will chase trades, and the less likely you are to revenge a trade. And if you didn't know it already, doing that will empty your trading account at a nauseating pace.

## **EMPLOYEE MINDSET**

When you become a trader, you become your own boss. Now for entrepreneurs or those of you with a natural entrepreneurial spirit, this will not be a major adjustment. For those of you who have been employed by someone else for most of your adult life—I won't kid you—that first step is a lulu.

Traders live in the results economy, which is to say that we get paid not for time spent doing something but for results and results only. Believe me when I tell you that the market does not care one bit that you or I spent six months or a year learning how to trade, or that we spent the better part of an evening analyzing charts or news and fundamentals or that you got up at 2 A.M. to trade Europe. Notice I didn't say “we” in that last sentence, because I just don't get up at those silly hours of the morning. Not being rewarded for effort and time is difficult for many new traders, and the lack of return for the hours can be very frustrating for the unprepared. So here I am—preparing you. This is a particularly tough habit for people with the employee mindset to overcome because time spent doing something is the measuring stick they are familiar with. If that isn't enough, there are other considerations, too.

It's not my objective to make trading sound simple and easy, because it's not. It's not because the skill is particularly difficult, but rather that



we humans love to complicate everything. There are challenges to trading just as in any other skill you are trying to acquire. I mean really, who here plays golf? Could anything be harder or more painful with the exception of childbirth? If you don't practice what I am going to teach you or think you are going to buy a piece of software that tells you what to do, then seriously, please give this book to someone who is going to use it.

All I am telling you is what I have learned the hard way. A smart person learns from her own mistakes. A wise person learns from the mistakes of others.

## CONFESSIONS OF A CHART JUNKIE

---

I still love charts, and they are still my bread and butter to finding, setting up, and managing trades. For every knucklehead who asks me: "You know what you find next to a sunken ship?"

"I give up."

"A chart."

"Ha ha."

I know that there is no way that trading news or fundamentals can work, without an understanding of how much or how little the news has been discounted into the market. So the battle lines are drawn: fundamental traders versus chartists. I don't think it has to be that way. I think a hybrid of each, knowing which to use when, is the ultimate solution. But I didn't always think that way.

My chart junkie ways started like most. An interest in learning how to trade and a charting subscription sent to my home each Monday. This was back when I hated weekends because the markets were closed. Yeah, I needed help or at the very least a hobby. There was little else I could get my hands on at this time in the history of mankind because there was really no Internet to speak of, and those giant mochaccino-lands with books didn't exist. So it was me, glued to a fledgling channel hardly anyone watched called the Consumer News and Business Channel and Schabacker's "Technical Analysis and Stock Market Profits."

I would sit for hours poring over about 30 end-of-day charts of the futures market. A pen and ruler and calculator was as sophisticated as it got. Forget streaming data and intraday charts; this was old school. You know there's nothing like going over printed charts manually with pen and ruler. If I sound like I am pining for the days of yore, I guess in some ways I am.

But it wasn't perfect. And I'm here to tell you that the bell curve of your trading will follow a path similar to mine, similar to a lot of traders

and would-be traders. As with anything new and exciting, you can't get enough. Not unlike your first car, first home, first puppy, or new love. It's all-consuming, and that's what makes it great. You're going to dive headfirst into that new charting software, demo trade the heck out of that new order entry platform (and start convincing yourself that the practice trades are real), read every book written on the subject of trading, attend seminars, watch CNBC, and nod as though you understand most of it, discover dead Italian mathematicians (Fibonacci), and probably start making a series of the worst trades ever made. Then and only then will you really start to learn. Sadly and typically, the pain must come first. Now, with your bruised ego, you do all of the above again. Only this time there's doubt and fear, and that's when you think that someone else has the answers. Here's a quick tip: They don't.

Most traders want to know everything. Pursuing that is, of course, insane. But we all get crazy for a bit, overcompensating for the fact that we know that we don't know nearly enough. As we begin to try and apply too much, naturally we begin that process of whittling away what doesn't work and what we don't understand. If we continue to do this, eventually we find that we're not looking to add but rather subtract until we find the handful of studies, tools, and whatnot that will finally conclude our search of "what works." That's closing the gate. Keep the stuff that you want out, and keep what you need in.

The quicker you can recognize where you are along this bell curve, the better and the sooner you can get to closing the gate, the closer you will be to becoming a trader. That's a fact! There is a common thought that you should never stop learning, and it's true, but knowledge is depth, not breadth. Knowing more is not always useful, knowing better, knowing deeper, with more understanding is.

It's more tempting out there in the world of trading, investing, and the markets than ever. Today's streaming data is more affordable than ever, and the charting platforms that you can find for free online are better than the platforms I used 10, 12 years ago and paid \$800 a month for. The indicators are seemingly unlimited, fast, and instant. But you know what, most traders still stink, I mean really stink: losers to the tune of about 90 percent plus. So it's not technology that's going to make us better traders.

You can use my approach to trade any market and any time frame, forex, futures, and stocks!

One of the biggest mistakes I see with traders is that they fail to understand that no market is an island. There's no such thing as a market that trades inside a bubble. Markets move one another and are connected across so many fronts: forex to futures to stocks and back again. I don't consider myself just a forex trader. I trade futures, stocks, options, and I do this not because with price I can level the playing field, get an unfiltered



read on market psychology, and trade liquid markets. I do this because it makes all my trading better. You'll learn more about the futures-forex connection when we discuss my Forex Market Pulse and the specific relationship forex has to the U.S. dollar, Dow Jones, crude oil, and gold.

## ANALYZING THE MARKET

I've set up some pretty lofty expectations, haven't I? So how serious am I about doing this in approximately one hour a day? No joke. No hype. I mean it. Time spent does not equate to success. In fact, I'll go so far as to say that if you were to reduce the amount of time you spend analyzing and trading—starting today—your returns would improve. Why? Well, Las Vegas knows why. They don't build billion-dollar casinos because they look majestic in the desert. While almost everyone you and I know tells us that they always leave Vegas a big winner, money in their pockets, someone has got to be telling a whopper because I'm pretty sure that the water bill alone at the Bellagio is enough to make my eyes cross. Now if you think I am comparing trading to gambling, I am, just a little.

While it may be blasphemy in certain circles, comparing trading and gambling there are similarities that it would do us good to notice. What I have observed is the time spent sitting at a casino will eventually empty your wallet if you don't know when to walk away, and I don't even gamble. The fact that most traders don't know when to stop does draw some similarities to their gambling cousins. Is trading gambling? Sure, professional gambling. I've worked with a professional gambler; he was written up in *Forbes* and was one of the most disciplined guys I have ever met. He regulated his diet on days he *worked*, which is to say the days he would gamble. He had a strategy, stop loss, money management . . . the works! I can't dismiss that as merely gambling. There are trends in games like craps just as there are trends in the EUR/USD or crude oil. Yes, I know there are differences, but I think we can learn a lot from professional gamblers, and I believe the main lesson is this, given enough time, the house will always win. Not because they are better, but because they are patient and will play every hand, every card, every roll. They know they are better funded than you or I. And that alone lets them be wrong longer. They wait us out.

Gamblers make small decisions by noticing the small nuances. Who hasn't watched 14 hours straight of the World Series of Poker marathon and noticed how the players size each other up? I've watched players at the craps table, and they will vary their bets according to hot streaks—is that much different than trading a trend? My point in all this is that much

of trading is psychological, and you are already in many ways equipped to trade. You just don't know it yet. So what are those nuances traders need to notice to play the market? They are visual tools, but instead you will use a price chart. Price is how we measure market psychology. It's a gauge of exactly what the buyers and sellers are thinking and doing.

So how do we know when to sit and play and when to watch? That's the key, isn't it? Well, playing more is not the answer. Observing helps. So does becoming a student of price action. Learn to watch price action without feeling a compulsion to play. That's discipline. The next step is knowing when to rejoin the game. For us, traders, we can rely on financial centers opening, closing, market overlaps, and scheduled news releases to signal those times. That's part of it. While we want to join the game at the right time, the other half of the equation is the market behaving in a way that we can capitalize on.

The three most common mistakes losing forex traders make are:

1. Risking too much on a single trade
2. Trading during the doldrums between the London close and Sydney open and overtrading during Asia without regard to the European open
3. Trading at the moment of news releases

And those are just a few examples. But the topic here is how to analyze the market quickly, and sometimes it's just as effective to discuss what not to do because you and I are going to spend the better part of the rest of this book discussing what to do.

The lesson here is not that I want you to be Vegas or Wall Street; we lack the capitalization. But I do want you to begin noticing what losers do. Vegas, Wall Street . . . they know what losers do, in fact they count on them. Losers behave the same way. They congregate in little herds of losers because they think and behave the same way. You know the old saying: If you can't find the sucker in the room, it's you.

Knowing when you play or walk away is a function of knowing what will make us act. I call them "decision levels." The market seduces traders. It's a siren song that is hard to resist when you feel that the next price could be a reason to act. The reason why Forex in Five traders will be able to resist is that price becomes our ally; specific price will cue our interest and begin analysis, and then, maybe, trigger a trade. Most traders make knee-jerk reactions because they incorrectly believe that any and all price moves are an invitation to trade. Watching the market this way is both unproductive and exhausting. Knowing that you have a price at which you have planned to act is instrumental to your success in trading.

## IDENTIFY THE TREND

*You* are not your entry strategy. If only I had a dime for every time someone has told me, “I’m a swing trader” or “I am a breakout trader” or—and this one is my favorite—“I am a contrarian.” Let me translate for you what each of one of these trading statements really mean.

“I am a swing trader.” This actually has two different meanings. First is “I enter trades and stay in them for anywhere from three to five days.” Okay, interesting, but does that mean there is some kind of alarm you set—an egg timer maybe—that goes off at a three- to five-day setting? And when it does go off, is it a mad scramble to the exit button? How do you determine if the trade is fully cooked at three days or five?

Second, and at least this one has more merit is “I am a trend trader.” Frankly, I have fewer issues with this translation as it is a partial truth. But first, how do you recognize a trending market? Sadly for most “swing traders or trend traders” every market is treated and thought to be a trending market, which we know of course is just not the case.

“I am a breakout trader.” To a breakout trader the whole world is a buy through a ceiling and a short through a floor. And if the markets were kind enough to consolidate and break out with that much predictability, everyone would be a trader, have six-pack abs, a full head of hair, and children that clean their room after finishing their homework every night. Breakout traders see the markets always as a coiled spring waiting to be sprung, and while this is actually an effective strategy in a sideways market, like any good strategy, it must start with the correct market cycle to be applicable.

“I am a contrarian.” Here’s the translation. “I pick tops and bottoms in trending markets mainly because I am not sure how to trade a trend and follow it. Instead, I choose a subtle form of revenge trading, looking to buy new lows and short new highs in between my hours of playing in oncoming traffic because I missed the move in the cable from 1.7000 to 2.1000.”

The bottom line here is that *you* are not simply a swing, breakout, or contrarian trader. You are all three, and the market will tell you when you use which one . . . if you know what to look for.

## TIME FRAMES

Anytime someone asks me, “What’s such-and-such market doing, Raghee?” I answer it by asking “Which time frame?” That must be the first consideration. A five-minute chart could be behaving very differently from a one-hour chart and different still to the four-hour or even the daily. The daily chart

is the most psychologically significant, but we should never assume that's where the trade or the action is! The easiest way to begin understanding what it means to analyze any market across multiple time frames is to view short time frames as the building blocks to larger time frames.

I trade forex off one of five time frames: the 30 minute, 60 minute, 180 minute, 240 minute and daily or end-of-day chart. Sometimes I'll look at a time frame as short as the 15 minute. But frankly, anything smaller than that begins to make less sense when you factor in the cost-per-trade in forex. With five, maybe six viable time frames to consider, there are not only the individual market cycles to consider, but there are risk/reward issues. Consider that daily charts, due to the fact that a single day's trading will represent a wider range from high to low than a 30 minute or 180 minute time span can, inherently has more risk because of it. So it's not enough to find a trade on a specific time frame; you have consider the risk that comes with it and whether the risk is appropriate for your account size and risk tolerance.

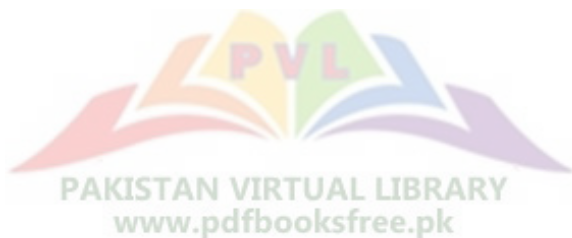
No daily chart is going to trend higher or lower or consolidate without the smaller, intraday time frames moving it there. That's the heart of the "brick by brick" philosophy. It takes two 15 minute candles to make a 30 minute candle, two 30s make a 60 minute candle, three 60s for a three hour or 180 minute candle ... see where I'm heading? It's the smaller time frames that dictate the direction of the larger time frames; it's cumulative. For those of you who use multiple time frame (MTF) confirmation, this is my reasoning for not using it.

I started out trading fully embracing the multiple time frame confirmation philosophy. I did it really for no other reason than I was told in book after book, that it's what I should do. So what is multiple time frame confirmation you ask? Generally, it's the process of confirming the overall direction of a market with a comparatively larger time frame. For example, confirming the direction of a 30 minute chart with the direction of the 180 minute or 240 minute chart. When you consider the "brick by brick" philosophy, this is a backwards way of confirming market direction. Remember that moving from smaller time frames to larger time frames is cumulative. Smaller time frames are the building block, the bricks, which build the larger time frames.

At any given time there is a very good chance that each time frame will have slight differences not only in direction but also the quality of that direction. The 60 minute chart may be in an uptrend but the 30 minute's uptrend might be stronger or steeper or correcting to support better. It's these differences we compare to determine which time frame we will set-up and trade. Here's another point to consider. Once you choose the time frame you will set-up, confirm, and manage the trade from that time frame alone. Later on, we'll be discussing market memory, and this will take care

of many of the issues traders have when treating a time frame in this manner. Most of the issues stem from a concern over not knowing all relevant points, support and resistance, on the chart. It's that feeling that you're not seeing everything you need to be aware of. Working from the market memory, coupled with psychological numbers, will help take care of this entirely.

There is some value in MTF, but I believe it's limited to comparing intraday time frames to the overall or "daily" time frame. For many traders, trading against the daily time frames is trading against the overall psychology of the market. Now, if there is a clear direction on the daily, this certainly can be a filter. But it's not a required one.



## CHAPTER 3

# The Wave



**The market is a 6'6", 280-pound kickboxer that will smash you. Don't fight the market.**

2006 "Fxstreet.com. The Forex Market." All Rights Reserved.

**I**f there is one indicator I cannot do without, it's the Wave. It's a simple market cycle indicator: a trio of exponential moving averages based on the Fibonacci number of 34. It provides me with a visual footprint of the market's trend, or lack of trend. It's better than trendlines, support, and resistance for this specific purpose. It's not that trendlines, support, and resistance are not effective but the fact is that these lines can be found

in uptrending, downtrending, and sideways or range-bound markets, and by themselves they do not indicate the market's cycle.

So what's the Wave? I'm not one for proprietary indicators, and anything I use to analyze my charts can be done with some simple indicator settings, all of which I will share with you. I will tell you why I use the settings I use, and then you will have to go about doing the real work, which is putting them on your charts and proving to yourself by watching how these studies/indicators behave that you can trust them and will use them. That's no small task. I'm not your mother, so "because I said so" just isn't going to cut it.

While I am going to talk about the Fibonacci series of numbers and their relevance to traders later on, let me just set the foundation quickly here by saying that Fibonacci is a mathematical law of nature. You will find that these numbers are not only accurate but consistent when it comes to measuring the ebb and flow, the expansion and contraction, of nature. Now do not confuse Fibonacci numbers with the popular trading tool Fibonacci Retracement and/or Extensions. I will be using Fibonacci numbers in a much more objective way in this book. Much of what makes most traders shy away from using Fibonacci is their assumption that it's the Retracements and Extensions or nothing. That method of using Fibonacci is and will always be very subjective, and subjectivity is something we want to come as close to eliminating from our analysis as possible. While there are aspects of the Wave and "clock angles" that will entail a very small degree of subjectivity, if you follow the steps I am about to share, you will substantially reduce the likelihood of seeing things "wrong" and make this tool as visually objective as possible.

It's not going to be enough for me to tell you that the Wave is created by three 34 period exponential moving averages, one set on the high, one set on the low, and one set on the close. That would be like my giving you three ingredients for a recipe without telling you how to prepare them. The preparation is everything. Let's first tackle how you are going to set this trio of moving averages up.

You will need a platform that will allow you to set-up multiple exponential moving averages. Why exponential? Well, first moving averages are simply taking a set number of highs, or lows, or closes and creating an average and plotting that number on the chart. If your setting is a 34 period on the close, then you are taking the last 34 closes, adding them up, and then dividing that by 34. You get a single plot. It's the accumulation of those plots that make the lines you see going across the chart. That straight average is known as a "simple" moving average or SMA.

But I said we were going to use an "exponential." So what's the difference? Exponential is a little "smarter" in that it takes that average of highs,



or lows, or closes, but instead of a straight average, it weighs more recent price action so that it is more reflective of the current mood of the market. How does it do that? Take a look:

$$EMA = \frac{p_1 + (1 - \alpha)p_2 + (1 - \alpha)^2 p_3 + (1 - \alpha)^3 p_4 + \dots}{1 + (1 - \alpha) + (1 - \alpha)^2 + (1 - \alpha)^3 + \dots}$$

Can I tell you just how glad I am that my charting platform does the work for me?

Essentially, what you are getting is a line plotted across your chart that takes into consideration that recent price action is more important than older price action and plots the lines accordingly. So the net visual effect is that if prices are currently more volatile, the exponential moving average (EMA) will reflect that, and if prices are consolidating, that will be factored in. I use exponential moving averages instead of simple because I feel that they better reflect the current market psychology without losing the overall feel of what has already happened.

I also mentioned that you would need a platform capable of setting this up. Again, these studies, or indicators, are fairly basic settings that even an entry-level charting platform should be able to easily produce. Your charts and data are your view into the market, and this is not the place to get cheap or apathetic. That's not to say you cannot find a quality, free charting platform. Forex traders all over the world use a very good one called MetaTrader4 or MT4. I do have MT4, however, my primary charts and data come from eSignal. Use whichever or whatever you want, but let me add that there is a difference between charting and charting/data. eSignal is a data provider, MT4 is a charting platform that relies on brokerage data. Let me digress here for a moment because I think it's important that you understand the difference, and this is specific to the foreign exchange market and data in this "non-exchange" arena. This will slightly alter how your indicators are plotted, how your buy and sell prices are quoted, and account for the differences you will see from platform to platform and from brokerage to brokerage.

eSignal provides what's known as composite data. This means that they have multiple contributors that make up their feed. In the case of eSignal there are over 200 contributing banks, institutions, brokerages, and corporations that make up their feed. I am simply using eSignal as an example. There are other composite feeds out there— this is just the one I personally use. Now contrast this with MT4, which is a robust charting platform that relies on an outside data feed, most commonly a brokerage feed. So with MT4 you are getting the feed from a single source as



compared to the composite feed with multiple sources. This data feed issue is unique to forex.

The foreign exchange does not operate from an exchange like stocks do or even commodity futures. Stocks trade from exchanges such as the NYSE or NASDAQ. The exchange sets certain requirements and also facilitates the execution of the vast majority of trades in the stocks that trade on them. This means that the price you see is the same that everyone else is seeing. Same goes for futures. Since the forex is “off exchange” there is no single entity that facilitates most or all executions of buy and sell orders. Instead, your brokerage either directly deals with you or provides you with access to liquidity providers through their internal network. This means that there is no standard, no way you could possibly see or have access to all the different liquidity providers or bids and asks that are available. However, most of the bid and ask quotes are typically within a few pips of the best, also known as the “inside” price. “Inside” is just another name for the current lowest ask price or current highest bid price.

There will inevitably be situations where one feed will have slightly different open/high/low/close prices, and since technical studies are calculated using the O/H/L/C, there can be some variance from platform to platform. Also consider that your execution price will vary slightly from broker to broker, but before you start asking me, “Who’s the best broker?” there is no broker that always has the inside bid or ask.

Now that you have some background of charts, pricing, and how that affects the indicators we will use, remember that it’s not a problem as much as it is simply the reality of trading the forex. Accept it and move on. In the big scheme of things, this is not going to be an issue.

Once you plot the three lines of the Wave, which again are:

1. The 34 period exponential moving averages on the high
2. The 34 period exponential moving averages on the low
3. The 34 period exponential moving averages on the close

... you can begin interpreting price action. Remember, the Wave is a market cycle tool first and foremost. Later, when I discuss what I call “Lazy Days Lines,” we will look into using the Wave as dynamic support and resistance.

The Wave is best and most easily interpreted by using what I call “clock angles.” We are comfortable with the visual of telling time on a watch, even when it has no numbers. We simply have trained our eyes to notice the angle to see the distinction between a two o’clock and three o’clock angle. I’m counting on this for Wave interpretation. When we work with visuals that we are already familiar with, we can shorten the learning curve.

## **SINKING, SOARING, OR SIDEWAYS?**

Real-time trend identification is vital to all traders. I don't know about you, but I don't want to wait for two, three, or four touchpoints to develop so I can identify a trend or wait for a channel to triangle to completely form before I can begin to decide if the pattern is occurring in a sideways market. It takes too much time, we give up too much potential profit, we end up being among the last to the party, and worse still there is no definitive way we can say that the lines and levels we are watching are occurring in the correct market cycles. Those are the issues all traders deal with on a daily, if not hourly, basis.

The main issue is this: Before beginning any analysis we must identify the direction of the market. This is no small task to do in real time across multiple time frames. The Wave is the only tool I know of that can do this. Frankly, because most traders don't know how or know of any tool to be able to confidently recognize a trend, they simply don't discuss it and therefore apply their strategies somewhat randomly. Swing traders treat all markets as trending; momentum traders approach all markets as range-bound. You get the picture. If all you have is a hammer, the entire world is a nail.

## **MARKET CYCLES**

Market cycle analysis is nothing new. When I first began learning how to trade, most of the books and articles I read were written in the early 1900s. Richard Schabacker and Charles Dow were my teachers. I have always thought that the basic gears of the market are basically unchanged. These men lived in a time before much of the regulation we see now in the financial markets, before computers and systems, before streaming data and charting, yet the reasons why what they did still works is because human behavior remains the same no matter what kind of technology is wrapped around it. It doesn't take long before the successful trader realizes that at the core of trading is understanding her own mind and understanding the mind of the market.

Specifically, when it comes to market cycles, we're talking about the mind of the market. The market is a gauge of psychology. Price does not represent the actual worth of a company or commodity or currency but rather the perception of its worth. This perception is affected by economic releases and fundamentals, and discounting these into price. Now if you think that somehow by not exhaustively researching this type of data you're missing something, think again. All this is represented in price, and price action creates the cycles of the markets.

Cycles are representative of the psychology of the market. When traders and investors are greedy, markets rally. When they are fearful, markets fall. When they simply don't know what to think, markets consolidate. It is vital that we understand this rhythm because it is how we will decide how to enter the market.

All strategies are based upon an underlying market environment. There are just four environments or cycles:

1. Accumulation
2. Distribution
3. Mark up
4. Mark down

**Accumulation** is one of two varieties of sideways markets. You'll have an easy time knowing the difference once you understand the psychology behind it. Accumulation is the quiet market—it's on the back burner. There's likely little news or traders are waiting on news and no one wants to be the tall poppy. The range is narrow as the market creeps along sideways. What's narrow? Remember, *narrow* is relative to the market's current range and typical personality. Each pair has a unique price action behavior so what would be narrow on, for example, the USD/CAD can be very different when compared to the GBP/USD.

When you look at accumulation markets, the Wave should be sideways or traveling at what I call "three o'clock." That's right, just like the minute hand on your watch or a clock. When the Wave is traveling sideways you have a visual confirmation of the fact that prices are not trending higher or lower but rather have found a balance between support (buyers) and resistance (sellers).

**Distribution** is the second type of sideways market. The psychology behind distribution is not as simple as that of accumulation as the psychology behind it involves two distinct groups. Most commonly distribution is associated with the exhaustion of an uptrend and the turmoil often seen once a group of traders exit the markets as another group buys into the selling. What is different however is the fact that the move essentially is over or at stalling and therefore the market cycle "turns over" from the trend to a sideways direction.

Since there is not a bullish bias in forex as there is in stocks and futures, and by bullish bias I mean a predisposition to buy and look for an increase in the value of the market, you can also find distribution at the end of a downtrend as well. Again, it is simply representative of one group of traders exiting the market while another gets in, believing the trend is still in place. Regardless of where the cycle occurs, it is very much the

collision of buyers and sellers, and it's this collision that creates a more volatile and wider range. When the market enters distributions, the main difference you will notice, as compared to accumulation, is the volatility. The Wave will be sideways but can travel not only at the three o'clock angle but also at what is known as a "two to four o'clock angle."

Two to four o'clock angles are unique to distribution and are more easily identified by what they are not rather than what they are. Let me explain. If a market is trending, it will be doing so at either a twelve to two or four to six o'clock angle. We already know accumulation is three o'clock. This means that its price action is sideways and the Wave is attempting to transition to three o'clock but is unsuccessful. We can be on the lookout for the two to four o'clock angle. It can't be flat, and it can't be trending. So essentially, it is a process of elimination, and we identify this two to four o'clock by what it's not.

A few other things to look out for on sideways markets, whether it be accumulation or distribution, is solid support or resistance. "Solid" simply means that the touchpoints that make up the horizontal or static level are within five pips or less. More than five pips and the level can still be considered static, but now it would be "soft."

**Transitions** between any of the four cycles are probably the toughest to deal with. These transitions will look as though one cycle is ending and another is possibly beginning. This is where you are most likely to want to have some sort of definitive way of saying that a new cycle is now set. But it's not that easy. It's not going to be as easy as my saying count three candles and if all three are traveling at the set clock angle you can say the transition is complete. But I just did, but that's not all I want you to do. It's more than the mechanics of counting candles. You must develop a feel for the rhythm of the market, and I know with time and practice you will. The market is just not that mysterious. It's not more mysterious than human behavior, and while humans are certainly entertaining, we're nothing if not predictable, and thus so is the market.

**Mark up** is just a fancy way of saying uptrend. Uptrends should be defined by support, which is a series of lower highs. Support is the key to maintaining an uptrend even within the context of pullbacks. Pullbacks or corrections are part of a healthy trend, and it's these moves lowering within an uptrend that actually help perpetuate it. Think about it a moment. If you are waiting for an opportunity to buy into an uptrend, first I must say "kudos" because most people just buy the new highs and that is not an effective way to enter a trend. But if you are one of those smart and patient few who wait for a correction to enter a trend, then you know by your acting—buying into the market—you are in effect supporting the uptrend.

An uptrend can be identified by the Wave traveling up at twelve to two o'clock. Once the trend is underway, it will probably seem unnecessary to

confirm an uptrend with the Wave, but please do not let your guard down. It's the slight nuance in the Wave, the transitions I explained earlier, that are so important to notice. The initial sign of an uptrend, its very earliest stages, are probably the most difficult to recognize without the assistance of a visual tool like the Wave. So make and keep the good habit: Confirm all trends consistently—no matter how obvious the trend may look—with the Wave's clock angle.

Confirmation of an uptrend being intact within the corrections that occur can be easily done with the Wave. Look for prices to respect the support of the three lines of the Wave, most especially the bottom line. If prices break down through the bottom line of the Wave while moving up at twelve to two o'clock, that's the first sign of transition or a potential turnover.

**Mark downs**, surprise, surprise, are a downtrend. The Wave angle you are looking for here is four to six o'clock. Downtrends are evidence of fear, and fear creates selling. Pullbacks within an uptrend are selling as well, but this is profit taking, and if it is true profit taking and the uptrend is intact, the lower prices of the correction will invite buying. Downtrends are different in their psychology because the emotion is much more extreme. People sell when they are fearful, and fear can come from bad news (most common) but also uncertainty. When in doubt, most traders will get out. When it comes to downtrends, gravity applies. Prices fall much faster than they rise. Because of this it is especially important that you stay sharp when waiting for bounces within the four to six o'clock Waves.

Trends in the forex are not as straightforward as trends in what I will call "single markets" like stocks and futures. If I am trading a stock, the price reflects the rise or fall of the perception of value of that company. The same can be said for commodity futures. If the market generally sees the value of crude oil is going up, it will generate buying. The consideration to buy or sell is determined by a single entity. It's different when you are trading forex pairs.

They are called pairs for a reason. You are trading a relationship between two currencies. Uptrends and downtrends are not necessarily reflective of fear and greed in the way they are in "single markets." Let's examine this because it's very different from the way most markets operate, since there are two separate markets that are being compared, and it's the relationship between the two that is traded.

To understand trends in the forex market, we have to break down the pairs into the base currency and the second currency, so that we can understand on which half of the pair the fear is and which half of the pair the greed is. Pairs are quoted in a specific way, and for the purposes of Forex in Five trading and keeping with the most traded pairs, we discuss the same six pairs I listed earlier, the U.S. dollar–correlated majors and comm dolls.



**EUR/USD.** The euro is the base currency here, and the U.S. dollar is the second currency. When looking at quotes of the EUR/USD, also called the “fiber,” you are seeing how many U.S. dollars you will need for each euro or conversely how many euro you will get per U.S. dollar. So if the quote is 1.2600 that means you need 1.26USD for each euro. An uptrend in this market reflects a strengthening euro and/or a weakening U.S. dollar. A downtrend reflects a strengthening U.S. dollar and/or weakening euro.

**USD/JPY.** The U.S. dollar is the base currency in this pair and the Japanese yen is the second currency. This pair is most often called the “dollar-yen.” When this pair is trending up, it is reflective of a stronger U.S. dollar and/or a weakening Japanese yen as higher prices reflect that the U.S. dollar gets you more yen. Lower prices indicate that the yen is stronger against the U.S. dollar or that the dollar is weaker against the yen.

Realize that one side of the pair can be enough to move prices higher or lower. The Japanese yen does not necessarily need to strengthen for the U.S. dollar to be weak against it . . . a simple move lower on the U.S. dollar would be enough. This is why data from each country involved in the pair is important and impactful. Additionally, because all the pairs have one thing in common—the U.S. dollar—the U.S. market and data coming from the United States is going to affect market psychology for these pairs.

**GBP/USD.** The British pound/U.S. dollar is called the “cable.” Traders seem to have a habit of giving everything a nickname. By now hopefully you are starting to see that the first currency in the pair is the base currency and when paired with the U.S. dollar, higher prices indicate base currency strength and/or U.S. dollar weakness.

**USD/CHF.** The U.S. dollar/Swiss franc is another pair where the U.S. dollar is the first or base currency. When the U.S. dollar is the base, then higher prices equate the U.S. dollar strength and/or second currency weakness, in this case the Swiss franc. When the “swissy” is trending higher, that means that each U.S. dollar is worth more and more Swiss francs. A lower trending swissy indicates Swiss franc strength and/or U.S. dollar weakness.

So as we round out the final two pairs, both of which are comm dolls, we can see that the **USD/CAD** (also known as the “Canada”) has the U.S. dollar as the base currency, and the **AUD/USD** has the U.S. dollar as the second currency. Since these currencies have a relationship with both the U.S. dollar and also a commodity, I refer to these as “split personality” pairs. There will be a triangular relationship. For example, the AUD/USD (Australian dollar/U.S. dollar) has of course a relationship to the U.S. dollar, but it also has a relationship to precious metals, namely gold.

We can add a seventh pair to this list with the **NZD/USD** (New Zealand dollar/U.S. dollar) pair as it moves very similarly to the “aussie” and has a comm doll relationship to the same commodities as the aussie. Additionally

you will see a relationship to the Continuous Commodity Index. Frankly, it is almost impossible to look at the forex market without considering secondary cues and confirmation from the commodity futures market. I certainly use these to my advantage, and I will teach you to do the same a little bit later. I consider myself lucky to have started my trading career in the futures market, and I encourage all forex traders to use this connection, since it is one that when correctly applied will give you more understanding of price action in the most widely traded forex pairs.

## A WISH

---

If there is only one thing you get (I do sincerely hope you get more than that) out of this book, it's the concept of market cycles. It's my wish that when you think of me, you think, "Yeah, that's The Wave girl and her market cycles." I hope you get so sick of me talking about them that you are bludgeoned into using them! I hope that you see that unless you know what cycle your strategy was designed for, your success will be hit or miss.

I hope that you take the time to understand what cycles your strategies are designed to take advantage of and also your indicators. There is not a more important concept than this, and the great part is that it will work and improve anyone's trading because it applies to every type of entry there is. Most of the time when I see traders struggling, it's because they don't know when to apply a particular strategy. They continually feel like they are buying when they should be selling and selling when they should be buying! And that's because oftentimes they are!

Market cycles let you know the difference between a correction and a reversal. They let you know whether a support or resistance level should be bought or sold. They let you know when the market is range bounce waiting for a breakout and when you should trend follow. I am standing on the shoulders of giants whose words seem to have been lost or forgotten by too many traders. I hope that you will see that the single best thing you can do right now, at this exact moment, is understand that without first identifying the cycle of the market, you are at best simply guessing at how you should trade the market.

## MARKET MEMORY

---

This is a simple concept and one rooted firmly in trader psychology. It is also vitally important that you use this concept when setting up your trades, finding support and resistance, significant highs and lows, and last



but definitely not least, getting a correct and consistent reading of the Wave clock angle on each time frame. Let's discuss the importance of how you determine what you look at on your chart. Now this is the first time we're actually discussing charting. Before now it's been mainly trends and relationships, but here we are going to start getting very detailed about chart set-up because, after all, this is how you are going to interpret price action and understand the market's movement.

One of the reasons you and I have spent so much time discussing concepts is because without this foundation there will come a time that you may abandon these methods because you quite simply don't understand why you were doing it this way in the first place. I think the only way I can prepare you for the rigors of the market is to teach you the why and the how. All instruction without concept is simply going through the motions. I need you to understand why you are doing your analysis in a particular way so that when things get tough you can stand firm knowing that there is a reason for the approach, and moreover you will have more confidence. Most traders simply adopt a methodology because they learned it somewhere and likely from a source they had some trust in. But it's not enough for you to have trust in what I am teaching or that I know what I am doing. If you cannot do this on your own, what's the point? You need to have trust in the instruction as much as the instructor.

Market memory is related in many ways to my not using multiple time frame confirmation. Most traders rely upon looking at many time frames so that they can identify key support and resistance levels. If I were to ask you right now to look at a chart, any time frame you wish, how would you determine how much data you would include in the chart? For most traders, this is completely random or determined by what is comfortable to look at, which again is completely random. The problem with this is that without an understanding of how much price action to view on a specific time frame, you are likely to miss relevant levels and move and totally misread the market's current cycle.

So you might ask, *What's the problem with looking at multiple time frames?* Well, first of all you should know by now that each time frame could and probably is moving at a different market cycle. Second, what is support on the 30 minute chart may not even register as support on a 180 or 240 minute chart. Third, and this is the main reason, it opens up a Pandora's Box of allowing you to begin looking for reasons to stay in a losing trade. If a 30 minute chart moves against you, it's just too easy to jump to the 60 or the 240 or even the daily time frame to justify your position. I've seen it far too often. If you set-up a chart on the 60 minute time frame, you manage it from the 60 minute time frame. The only way you can do that is to make sure you are looking at and making your analysis from a complete market memory.

Each time frame has a specific market memory. The reason is that short-term time frames literally have short term memories, while longer time frames, like the 240 minute or the daily (also known as the end-of-day chart), require more data to make a decision because monthly and yearly high and lows matter. This is partly due to the number of candles you get per day on different time frames. We already discussed the brick-by-brick approach to time frames so you already understand the number of candles we get per day. To make a decision on a longer-term time frame, I am simply going to need more calendar days to generate a sufficient number of candles on the chart in order to see significant highs, lows, rallies, sell-offs, support, and resistance. But what is sufficient?

I began asking myself the same question years ago and started seeing some obvious clues in the way specific time frames respected certain price levels, depending upon how long ago the level was established. I was mainly interested in how far back I could go and whether or not traders reacted to older highs or lows. I began to see that each time frame had a general “memory,” which is basically a limit to how far back support and resistance would be respected. The easiest to figure out was the daily.

Traders are very aware of 52-week highs and lows, and this not only allowed me to determine that the market memory for a daily chart was one year, it also made it very clear that these 52-week highs and lows were psychological levels. So for a daily chart, you need one year of price action on your chart. It is also in this view, the complete market memory, that you will take your clock angle reading of the Wave.

Reading the Wave can be subjective if you do not look at the clock angle within a specific amount of data. The X axis (horizontal) and the Y axis (vertical) are affected by your charting platform. Most charting platforms will try to automatically squeeze in the closest recent high and low from the current price. This “auto scaling” means that you will not have complete control of how much data is on your chart, but we’re not looking for nor do we need that much accuracy. In fact, market memory is really designed to be more of a guideline to keep a trader from putting “too much” or “too little” price action on a chart.

If you were to expand the horizontal or X axis of your chart you would also be flattening out the angle of the Wave. Squeeze in too much on the X axis and you could and will most likely artificially steepen the Wave. So, yes, market memory as applied to the clock angle of the Wave is very important.

For the 30 and 60 minute charts, the market memory is two weeks. This two-week view will represent the significant highs and lows as they pertain to the 30 and 60 minute chart. By the way, even though we haven’t yet discussed it, there are other very easily identified levels called “psychological levels” that are observed beyond that of what is included in the market

memory, and we'll talk about those shortly. And I know I mentioned this already, but if you cannot fit two weeks exactly into your chart view, you can simply err on the side of slightly more rather than slightly less.

Since I trade the 30 minute, 60, 180, 240, and daily charts, those are the market memory settings I will get into detail here. But you can apply this psychology to any time frame so I will also include a few other settings on some popular requests that I get. The 180 and 240 minute charts should include a look back of no less than one month. With these two time frames I have no problem with going out as far as 8 to 10 weeks although one month/four weeks will be absolutely fine and effective. Personally, due to the way my charts typically compress on my charting platform, I am usually looking at four to six weeks.

The most popular requests I get for alternate time frames are the 5 and 10 minute, 120 minute, and weekly. For the 5 and 10 minute time frames, work with a 3 to 5-day market memory. For the 120, use the same settings as the 180 and 240 minute charts. Finally, for the weekly, which actually I do refer to for big picture trades and significant longer-term highs and lows, it's a five-year market memory.

So let's review because I've thrown a lot at you here. The main reasons for using market memory is to make sure you are looking at the most relevant price action and reading the Wave for the most accurate clock angle reading. When it comes to Forex in Five trading, the chart set-up, making sure you are looking at price action in its proper perspective, will add up to quicker and more importantly, more accurate analysis.

## TRADE WITH PRICE

---

If it isn't already obvious, I want you to rely on price and price action to make your trading decisions. This isn't because I don't respect fundamentals or data—in fact I do—but they are not reliable when it comes to market timing (your entry) and market direction. This is due primarily to the way news filters through the market and is discounted. Discounting is the process by which news and data is factored into the market, often well ahead of the actual information or data that is released or confirmed. The markets are always forward looking. This means that what traders think *may happen* is what moves the market.

One simple way of seeing this at work is looking at data releases and the way market participants factor in the forecast or consensus of a report and the way they react to the actual data. So it's not enough to simply see that a news event has beat or missed expectations (the consensus). You must also factor in to what degree the number beat or missed its mark and

also know beforehand how much the consensus was discounted into the market. The very act of trading news requires that you understand price action. You will notice with frequency that “good data” can make a market sell-off and “bad data” can make a market rally. Again, the data is not compared month to month, or whether the number was positive or negative, but rather it’s compared to what traders expected the number would be. So is trading news and fundamentals a level playing field? Heck, I forget if it is level or not . . . it’s hard enough to even find the field itself!

Another factor that makes fundamental analysis unrealistic for not just Forex in Five trading but for most traders is that it is time consuming to gather and analyze the data, all the while knowing that you may not even have the complete picture, or all the data, or even the correct data. Then you must take the last step and determine how much of what data is already factored into price. And I’m not overcomplicating this. This is the process. Instead do what I do, focus on two numbers, the consensus, which is what is most widely baked into the cake (discounted), and the actual, which you’ll find out when everyone else does. This brings up another issue with trading news, the order entry. I will go into detail about order entry in the next chapter, but I want to mention here a few salient facts.

Let’s be realistic. I am not some hotshot trader at a bank or a pit trader with instant access to the market. I am a home office–based, private trader. I can’t trade as anything but that. Nor should I try. I am not privy to all the latest market intelligence, and I can’t delude myself into thinking that I know something that the market doesn’t. Order entry during economic news releases is insane at best and stupid at worst. Order entry platforms have a terribly inconvenient tendency to freeze during these volatile times. Spreads widen, the market jumps. I don’t want to be in the mix during these times but I can still take advantage of trading the moves that are generated during releases. You see the follow-through may come from the release itself, but more often than not, you will have an opportunity to set-up and enter a market in advance of the release—if you watch price action, that is. It’s not that common really for prices to make sharp reversals from economic releases. More often the data simply hits the accelerator in the current direction. Weak gets weaker, strong gets stronger.

Are there advantages to being a small trader? Sure. I am nimble, and the market won’t see my trade size coming. Frankly, it doesn’t care. I can watch the big boys make the moves, and I can react to them knowing that the moves they make are large. I can move under the radar, in and out, and do it all over again. Why have I relied on trading price? It’s the only level playing field, and there’s just too much news and fundamentals out there to paint a complete picture and act on it with confidence. *I’m never going to know everything, although I try to convince my husband that I do.*

## CHAPTER 4

# Objectivity



**Tame the market or it will eat you alive!**

2006 "Fxstreet.com. The Forex Market." All Rights Reserved.

**O**bjectivity is at the heart of Forex in Five trading. It is through the use of trading tools and studies that require little to no interpretation that we can make fast decisions and have confidence in them. In my experience, far too many trading tools and approaches are subjective in nature. By the way, you've already learned to eliminate the largest problem in subjectivity. You know what that is? Market cycles! Is the market moving up, down, or sideways? That distinction alone can make the difference in your current trading. If you did nothing else but figure out what cycle your current strategy was designed to trade, and then go about using

that strategy in the appropriate market cycle, you would make a profound improvement in your trading with that one adjustment.

For most traders, their selection of a trading entry is what I call *canned*. They simply memorize some steps and apply it to the market irrespective of the underlying market cycle. The market seldom sets-up a trade the same way all the time. There are nuances, slight differences, which can often make one version of a set-up look different from another. Most books and educators unfortunately focus on the well-chosen example: that one textbook example of the strategy at work. So now you go looking for that one because that's all your eyes know to look for.

It all reminds me of when I first began teaching. I would teach for instance, a triangle pattern to the group. The next session when we sat down to analyze the markets, all they would see would be triangles. That's the only frame of reference they had, or it was the one that was the freshest in their minds, so that's what they would look for. Funny thing about the human mind, it may be powerful, but it's not necessarily smart. If you ask it a question, whether it knows the answer or not, it will give you a reply. "Hey, let me ask you, why are you such a terrible trader?" Tell me now, and your brain is probably firing off one ridiculous reason after another. That's what it does. And you know what's worse? You may not even be a terrible trader, but since that's what your question assumes, that's what your brain will respond to. It's difficult enough to trade and deal with market psychology, but now I'm telling you that you're going to have to deal with what I endearingly call the "pig in the head." Don't ask the pig much, which will keep it quiet, and trust what your eyes see on the chart.

The more subjective or open to interpretation a trading tool is, the more the pig in the head will get involved. Subjective tools invite doubt and they are time consuming, yet most market analysis methods are subjective. Do you think fundamentals are objective? For every piece of bullish data or news you find, I can find you a piece of bearish data or news. Where's the objectivity there?

## INDICATORS

How about indicators? I remember a trader long ago trying to explain his stochastic entry methodology to me. First it was based primarily on the indicator itself and not price (first warning!), and it was reliant upon my learning to recognize this squiggle of a move on the indicators lines (second warning!). *Okay, I thought, he's well intentioned, and this shouldn't take too long.* He showed me a few examples, told me it was really easy (third warning!), and off I went to try and put this to work.



I thought I had found a few good instances where the stochastic squiggled in the right way. So I clicked off a few demo trades. It didn't work, which is to say the trade was a loser. But I know that a losing trade is not indicative of a methodology not working. Nothing wins all of the time. So I did it again, and again, and again. It still couldn't seem to generate the entries as he had described, so consequently I would wander back over to his station only to see that he was up! All the "wrong" triggers I took were none of the ones that he took.

"What gives?" I asked. "I did it just like you told me to with this little squiggle here."

"Oh well, you see your trigger didn't squiggle like this . . .," and he proceeded to show me his squiggle triggers.

"They look the same to me," I replied.

"No, no, no, yours crossed like this but mine crossed like this."

This is subjectivity. I'm not saying his stochastic squiggle trigger did not work (but I will add that after the stock market boom of the late 1990s and early 2000s ended, so did his run as a daytrader), but I could not replicate it. I couldn't see it the way he did. Darn subjectivity.

What good would it be if I showed you a bunch of strategies, and you couldn't recognize them for yourself, by yourself? I'd be wasting both our time. Since I am both a trader and a teacher, objective tools are a must because that's the only way I can be sure that there is a high likelihood that you will see what I am seeing! *The reason so many traders lose more than they win is that most tools set them up for failure due to the fact that there are too many nuances in interpretation and the market just does not set-up the exact same way time after time.*

## ORDER ENTRY

---

I think there is too much and not enough discussion of order entry. I can and have talked about the mechanics of entering a buy or sell order with limits, stops, or at the market. Mechanics and definitions don't do the art of order entry enough justice because they make it seem flat and lifeless. In reality order entry is dynamic.

I have seen over the years that most traders use market orders. This is the "get me in" or "get me out" now order. A market order in the wrong hands and if overused is not unlike the lever on the slot machine in Las Vegas. It's the impulse buy while checking out at the grocery store. The psychology behind the most common use of market orders is little planning and even less trade and risk management. Now I am not saying that all market orders are somehow misguided, but it's usually only very skilled and disciplined traders that should use this order type with any frequency.



If a trade is planned ahead of time, before price triggers an entry, then it should be logical that if the trade is preconfirmed a few orders can be “parked” in the market. When I say “parked,” I am referring to pending orders such as limits and stops. These orders can be placed well ahead of time and handle the trade entry, risk-based stop loss, and initial profit target.

I don’t think at this point we need another discussion of what stop, limit, and market orders are. I think the main issue is why and how we place these orders. In fact, it’s really more about the job each one of these orders has. We only have three order types, but which we use has more to do with how we want to communicate our wishes to the market.

## STOP LOSS

Let’s examine stop losses. First, there is really no such order as a “stop loss.” We’ve called it that because stop orders are most commonly used in this protective manner, but they are still simply “stop” orders. There are three types of stop losses we will want to use at different stages of a trade. They are all going to be stop orders, but the thinking behind each stop (stop loss) order placement will be different. The initial stop we place when entering a trade is known most often as the protective stop loss. This stop loss represents the potential for loss. It’s a risk-based stop, and it’s placed where the trade would no longer be valid. The risk-based stop is the opposite of the entry. If an entry is the reason to get in, then the point of validity/risk-based stop is the reason to get out.

The risk-based stop is the one we all hope we will have the discipline to place and not have to use. Transitioning from a risk-based stop to a breakeven stop is done only when the trade moves in our favor and to the first stop loss. It should become clear right about now that using support and resistance to place stop loss and profit targets is important because a market moves from level to level seeking support and resistance. The way you place your profit target, the thinking behind their location, is what will set your risk management in motion. This is lost on far too many traders. This is how far too many traders let a winner turn into a loser. How do we define a winner? It’s a trade that has reached the first of hopefully two to four more profit targets. How do you manage two to four profit targets? That is done with multiple lots.

Once prices reach the first profit target, the trade is officially a “winner” and should be protected from a reversal that could happen when prices reach the support or resistance that was the profit target. This is a possible scenario when prices reach any kind of support or resistance, and since

just about any order you place will be because of the support or resistance it has, then there is the possibility of either a continuation through this level or a reversal.

The psychological trade many traders fall into here is trailing their stop too aggressively. This is usually because they have experienced so many losers during the early part of their trading and learning curve that the slightest profit triggers a fear reaction: I have to take this profit now! Many times the traps that most of us have to navigate through can be avoided with order entry that lets us observe the market rather than being involved with it too hands on once the trade goes live. There is too much temptation, fear, and greed, and the only way we can avoid and manage these emotions is with order entry.

First of all, the only way a trade should and can be extended past the first profit target is to have multiple lots. One lot equals one profit target. A breakeven stop allows for enough wiggles (the typical amount of volatility) that a position must be given in order to compensate for corrections along the way to the next profit target. Trailing stops are most often and incorrectly done by using some sort of fixed pip or percentage. I've already explained why stop losses should not be placed with this type of thinking, and the same thing applies to every kind of stop. Trailing a stop is done as a trade moves in the direction we expected it to and reaches profit targets, which then in turn trigger the transition from risk-based to breakeven to finally trailing stop.

A breakeven stop, as the name implies, is where the trade would be stopped out and yield no loss or gain. It's placed either just below the entry price if the entry is a buy or just above the entry price in a short. The breakeven should be just beyond the entry as to be able to get maximum use out of the support or resistance that triggered the entry. As a trade progresses, if it progresses, the trailing stop is next.

Trailing stops are what we all love because they mean that no matter what, the exit is still a profitable one. But they should not be placed with fixed levels that trail current prices. The same levels that were once profit targets are now going to be valuable levels of support and resistance that the trailing stops will be placed at. Here's how it works. On the chart there are multiple levels that the trade could travel to as it moves in the profitable direction and these levels are resistance in a buy and support in a short. Remember that what was once support becomes resistance and vice versa, so that now we are looking at a set of levels that can support prices in an uptrend and be a ceiling in a downtrend. This is exactly what we need for trailing stops.

The stop order itself should not be placed at the profit target level exactly but just beyond. So that means that in a buy, the resistance levels that were once profit targets are now support and trailing stop levels. Place the

stop order just below the support level. In a short it's the support of profit targets that have become resistance so the stop order will be placed just above that level. How much above? Three to five pips to account for the spread will do.

## RISK MANAGEMENT

So you can see that under the overarching idea of trade management is risk management. Risk management is your risk-based stop and breakeven stop. Once you are in the inevitable position to make the happy transition to a trailing stop, the trade technically should no longer be in a risk scenario.

I started with risk management because it's the side of the trade that no one really likes to consider; it's the order we hope not to see filled. The profit side of the trade, the reward, is just as important, however, to risk management because it's where we define a winner that initiates the stop loss order progression. Improper placement of a profit target will delay or incorrectly trigger the risk management orders, and the trade could be handled poorly as a result. Profit target placement is not difficult because like every aspect of the trade, set-up is determined by support and resistance. Before we get into limit orders and profit targets, we first need to discuss the risk-to-reward ratio.

The risk-to-reward ratio is the consideration of how much we are risking in order to potentially gain from our trade. We all would like to risk a little and gain a lot. That's human nature: risk averse and greedy. Once we acknowledge that we cannot effectively trade with that behavior, we can examine how to really determine the risk/reward of a trade. First of all, you probably are already familiar or even perhaps using a fixed pip or percentage. This is an erroneous risk management strategy because it ignores the support, resistance and pip movement particular to the time frame we are trading and the current market environment. The idea that we can randomly pick a 1:4 risk-to-reward ratio simply because that is our tolerance implies that a trade is simply a throw of the dice. If that's the case, then why analyze anything? Play the odds, and enter wherever you wish!

Risk/reward ratios, like everything else in trading, are a matter of support and resistance. If you are buying (going long), your risk is your entry to your risk-based stop loss (support), and your reward is your entry to your initial profit target (resistance). Calculate those levels, and you have a true representation of the risk/reward ratio before you enter the trade. If you use (for example) a 1:4 ratio, then that means the placement of the stop and profit target are not based upon support, resistance, or price action at all. Instead it is driven by the desire to risk little and gain a lot.

If you ask most traders they will tell you that 1:2 risk-to-reward ratios are a gift because most of the time, if you are using price as the measuring tool, a 1:1 is normal. Upwards of 1:2 is fantasy and likely derived from completely ignoring the support and resistance price action it is actually pointing to. Most of my traders are 1:1 or 1:1.5. I can hardly recall a 1:2 in recent memory. And while it sounds good to say I am risking “1” in order to make “4,” it does not pan out when analyzing the price action.

Limit also known as “or better” orders will be used to execute profit targets. A limit order will simply wait for prices to reach the level and then execute at the price designated and or better. Stop orders can also be used as a profit target order since both are “pending” orders that lie dormant until the price designated in the order is hit.

There are some considerations when placing a limit or stop order, and the first is psychological levels. At all times you must have a good feel for where current prices are in relation to the “00” and “50” levels, which are major psychological numbers. Orders congregate at these levels creating strong and significant support or resistance. Important but secondary to the major psychological numbers are the “20” and “80” levels, which are minor psychological levels. When entering a trade, look to see if any of these levels—most especially the “00”—are nearby. If you are buying below a “00,” you are essentially buying below a ceiling, and that’s not ideal. Wait until prices can pierce this level and the mass of orders that are waiting there. By doing this you will accomplish two things: (1) you will be able to buy above a ceiling, and (2) the break of the “00” could very well propel prices higher.

In the case of using a psychological level to your advantage when placing a protective stop loss order, use the resistance or support they provide. I love when I can use a “00” as a ceiling in a short or as a floor in a buy. It’s a powerful level that can be an asset to the trade. The same goes for profit targets. In situations where your trade is moving toward a psychological level, you’re going to want to “step out in front” of the size and orders that will be waiting there. So imagine that you are short and prices are heading lower to the “00.” Your profit target should be preferably five pips ahead of the “00,” putting your order at the “05.” When long and prices are heading up towards the “00,” the limit order (or if you are using a stop order as a profit target) will be at “95.”

In fact, for many traders, psychological levels are the easiest and the most powerful support and resistance levels on a chart. They are reliable because they are not necessarily required to be confirmed by price action as support and resistance. They work because of the way we gravitate towards whole, round numbers. The psychology of market participants is what makes them reliable and relevant.

The ultimate aspect of order entry is you. A trade is an emotional thing. There is excitement and fear, greed and expectation, denial and anger ...

and that's just on a good day! The idea that we can trade unemotionally is ridiculous. I see mention of it, but removing emotion from trading is next to impossible. Our egos and money are on the line. There are some steps we can take to remove ourselves from the equation. The problem with most emotional trading is that unlike betting on a horse race, where once the race starts you just wait to see where your pony finished, in trading you can keep going back and keep changing your bet. That's the main challenge most traders face, the betting window never closes once you've placed your initial bet. To keep from going back we use order entry to instill some discipline and reduce the urge to tweak. It's not a perfect solution, but at some point there has to be a line that you know not to cross. Here's how we can begin defining that line.

The best thing to do is avoid market orders. These are the ultimate temptation and a trade tweaker's nightmare. You likely know a trade tweaker, or maybe you are one yourself. These are the unfortunate traders who cannot follow the plans they laid out before the trade was initiated. I call this the "sane" part of the trade. We're all in control or at least in better control of our emotions during the trade set-up, which is to say that once we enter the market most of that control gets thrown out the window! Since we know there is a better chance of seeing things more clearly and making plans with less emotion before the entry is triggered, it makes much more sense to use pending orders like limits and stops to tell the market (via our broker's order entry platform) what we'd like to do. That means entering an order for the entry, entering an order for the initial profit target, and certainly entering the order for the stop loss. The last is the most important because we're most likely to negotiate this one back if price moves against us.

Don't neglect the parked profit target order though in terms of avoiding the pig in the head. The pig will tell us to try and take more profit, try to "ride the trend" regardless of whether that's valid or not. Many traders will jump out of a winning trade too early just as easy as they will ignore a stop loss. Most traders find themselves following behavior that makes them take profits entirely too early and push stop losses way too far back. Consequently, we can make small profits and suffer large losses. I say that this can be modified by good order entry: more specifically, pending orders parked in the market, and this includes the entry order.

The phrase "set it and forget it" has found its way into our lexicon and is probably the best way to describe what I want you to do with your order entry. There is really no way of becoming a Forex in Five trader without mastering the "set it and forget it" order entry habit. First because it helps you manage *you*, and second it is the only way to free yourself from the office chair. Setting it and forgetting it should be really more of "setting it and following it" because the goal here is to place your orders and then see

what the market does. You've done the analysis, and only bad decisions will be made if you go back and tweak. Now, of course, if there is a reversal, there will also be a set-up, and again it's a matter of putting the order as the market cycle and price action dictates that will allow you to have a confirmed reason to change your opinion.

## **TRENDLINES, SUPPORT, AND RESISTANCE**

---

Let me first say that I love manually drawn support, resistance, and trendlines. These static and dynamic levels have been my bread and butter for years. But they also took me years to get good at and even more years to get *good and quick* at. When you add support, resistance, and trendline's cousin, chart patterns, to the mix, then you're talking about even more time-consuming and subjective analysis. Since our goal here is to get you to do about an hour a day in the forex market, and with positive results, then we have to focus on less interpretative but equally powerful analysis methods.

There is the option of automating these levels with some of the many software programs that will do this for you. Still, though, you must first have the skill to find these on your own before automating the process. I use EZ2Trade Software, Autochartist, and a host of plug-ins on my MT4 platform to give me a helping hand, but really this is a luxury not a necessity. Another one of my favorite tools are Lazy Days Lines, which are Fibonacci-based moving averages that act as dynamic support and resistance levels. They are like cousins to my Wave.

However, before you finally decide to identify support and resistance, remember that before automating anything, you must have the skill to find these levels on your own. Otherwise, you'll never develop the discretionary eye to know when the lines and levels a piece of software is drawing are off or flat-out wrong. I learned to drive a manual transmission before going to an automatic. Same idea I am espousing here. Learn to do it manually; otherwise, you'll never have the skills if you adopt automation first.

## **STATIC AND DYNAMIC LINES**

---

There are four considerations when drawing manual uptrend lines, downtrend lines, horizontal support, and resistance. You're not going to be relying on subjective lines like this; however, it is important that I teach you some valuable tips to doing it correctly. Ignorance is not bliss.



There are major and minor trendlines on any chart, and these lines are drawn from the highs and lows (otherwise known as touchpoints) that occur as price action rises and falls. It's when a trader draws lines across the tops of the high touchpoints, playing a version of charting dot-to-dot, that you get the lines and levels that most traders use for entry. But these levels will vary from trader to trader and from time frame to time frame, and that makes them what? Yes, you know it: subjective.

There are a few things we can do to draw better, more reliable, trendlines, support, and resistance.

First, work within the market memory. Look for touchpoints within the market memory of the time frame you are looking at. Too much data, and you will be drawing lines that are not relevant. Too little, and you will be missing out on larger, significant lines and levels.

Second, note how many touchpoints were used to draw the static (horizontal) or dynamic (trendlines) line. More touchpoints make the line more significant, as this reflects more respect for the resistance or support it provides. Obviously you need at least two touchpoints to draw the line in the first place but if you have three, four, or more, then make a note of that, as it's likely that it is a major dynamic or static line.

Third, look at how the touchpoints you used to draw the line are spaced apart within the entire market memory. Are they all huddled close together, or was there a healthy amount of spacing between each touchpoint? You are looking for some spacing, as that would indicate that there is an ongoing and longer-term impact from the line. You also want to note how far back the line or level started. Was the first touchpoint deep within the market memory, or did it originate with more recent price action?

Fourth, and this is the last consideration, is proximity to current price. Is the line or level far from current prices, or is it close and therefore more likely to affect prices near term?

As you consider each one of these criteria for each line you have drawn you will begin to notice which are stronger and more likely to impact price action. These questions presuppose that there is more than one line or level on the chart, which is often the case. I'm not sure when traders were told that they can only draw one line: one downtrend, one uptrend, one support, one resistance. There is not a quota here! There are often multiple downtrend lines, major and minor, as there are multiple uptrend lines. Draw them and then after that you can step back and run them through the four criteria I just walked you through. This will allow you to prioritize them.

Now as we look at other forms of dynamic and static lines and levels such as my Lazy Days Lines you're about to learn, keep these criteria in mind.



## CHAPTER 5

# The Magic of Lazy Days Lines



**The siren song of the markets can be alluring. Sometimes too alluring. Learn to walk away.**

2006 "Fxstreet.com. The Forex Market." All Rights Reserved.

**F**ibonacci is not a trading tool; it's a mathematical law of nature. Leonardo de Pisa was an Italian mathematician who was given the name of Fibonacci posthumously, Fibonacci being derived from *filius Bonacci* or "son of Bonaccio."

I am particularly interested in Fibonacci numbers in nature. Whether you are looking at the rise of pyramid walls, spirals of a nautilus shell, leaves on a stem, fruitlets on a pineapple, the flowering of an artichoke, the bumps on a pinecone, the way cells split, the curves of a wave, or the

branching of trees . . . they can all be explained by the Fibonacci sequence. But the best proof is seeing these lines at work as they show you dynamic support and resistance on a chart. So let's get to it. Just remember that these lines are not just trading tools. The bigger picture is that they are able to consistently project psychology and human nature.

In this chapter I will share with you how I incorporate Lazy Days Lines on a daily basis. The Lazy Days Lines (Fibonacci-based moving averages) are the short cut—the objective alternative. This is the best way in my opinion to identify support, resistance, and trendlines more objectively on your charts.

## NOTE

All of the figures in this chapter can be found in color at: [http://raghee.com/Home\\_ForexinFive.htm](http://raghee.com/Home_ForexinFive.htm).

## FIBONACCI ANALYSIS

Fibonacci levels, whether they are retracements or extensions, are simply support and resistance that is calculated from the last major move. Another way of saying that is that the markets continually retrace their moves, and we can identify these when we locate the most recent, most significant rally or sell-off. Within these moves are the levels that price action will attempt to climb up or climb down, and that's the way support and resistance works. Fibonacci analysis is subjective because there could very well be more than one *last major move*. Consider that when analyzing a pair, the last major move could be different from time frame to time frame. This is exactly why charting analysis should be confined to the time frame that you are setting up the trade on.

The subjective nature of Fibonacci can be a bit of a turn off for some traders. But given time you will be able to recognize Fibo levels with ease and then you will see clearly why it was worth the effort. The best reason that Fibonacci works is not the fact that so many traders use it. In fact, the way a 200 simple moving average can affect trading is based upon the widespread use of this moving average at the 200 period setting. Fibonacci is not that objective. On a given chart there could be multiple moves from which a group of traders could identify a Fibonacci Retracement series so it's not the commonality that makes them work . . . it's far more interesting than that. Fibonacci, because it is a law of nature, will take a move and calculate what it's most likely to do after making that move. It's the idea of the natural ebb and flow of life, the way all things in nature contract

and expand. Fibonacci simply measures human nature, fear and greed, as it plays out in the markets. This is why it works even when you don't necessarily have the "most correct" last major move. This subjectivity is very uncomfortable to traders who need to put market behavior in convenient categories—as if human nature were always that simple to decipher. All Fibonacci seeks to do is identify support and resistance or "decision levels" at which bulls and bears will try to see who is in control.

Whether the levels used are Fibonacci-derived, pivot points, psychological levels, moving averages, chart patterns, and so on, the idea is the same: What is the psychology that got us here? Where (at what price) will the next decision to go either higher or lower be made? Regardless of what tools you use to analyze the markets, that is the only aim of chart analysis.

## LAZY DAYS LINES AT WORK

This should be law: All fish should be offered in a deep fried coconut crusted version. My favorite restaurant takes fresh snapper, grouper, you name it, and fries it in coconut batter and serves it on fresh bread with mango chutney. It is sublime. Lazy Days Restaurant sits on stilts oceanside in Islamorada at mile marker 79.9. Chef Lupe fixes the most unbelievably amazing seafood dishes I have ever had, and I look for any reason, occasion, or excuse to go there. It's a two-hour drive so my husband and I will make a day of it and spend a few hours at the restaurant when we go. I bring my laptop (notebook, netbook, whatever it is that they call these things now!) which unplugs me from my office thanks to my laptop connect card. I have executed quite a few trades while enjoying my fish sandwich, and even losses don't sting as much when I am at Lazy Days. Oh, did I mention the passion fruit iced tea?

With all the traveling I do these days, and all the abuse my laptop goes through getting past airport security, it's no wonder I seem to dispose of them with alarming frequency. I had just bought a new laptop after yet another tragic loss. It was a few days later that we decided Lazy Days needed a visit. So I threw (no that should be "gently placed") my laptop, my laptop connect card, a few sticky notes, and the power cord into my rucksack, and we were gone. It's days like those that I sit back while staring up through the sunroof of my husband's truck that I say to myself, *Yeah, so this is why I love being a trader.*

My joy was short-lived because halfway through the mozzarella sticks I realized I had not yet installed any kind of software on my laptop. Stupid! I had also entered some trades before leaving home. Stupid, stupid!

I started my laptop up, downloaded eSignal, and stared at the unfamiliar layout. Back at my home office I have my chart layout sized exactly the way I like to look at them. I have my Wave and confirmation indicators. I

even run a plug-in that automates trendlines, support, and resistance levels for me. And none of it was here in Islamorada. Sure I could draw my own trendlines. But amidst my Lazy Days meal euphoria I decided to relax. I was in the Keys after all and decided to try a few things out.

The eSignal that runs in my home office is spread across four screens so I watch quite a few charts, and I have a few off in the corner of one screen that I play around with some ideas. One of them had been in the corner of my screen ever since I had originally tested and began using the Wave. You see, before I decided to use the 34 EMA, I had tested the Fibonacci series thoroughly for market cycle indication all the way to the 144 and even had gone up to 6,765. While I was plotting and testing these Fibonacci-based exponential moving averages, I had noticed that they all offered dynamic support and resistance across all my charts. At the time I was just looking for a market cycle indicator, but I felt like the chemist who was trying to invent the strongest glue ever known and instead made a really weak one. But then he decided to put this really weak glue that left no residue on little yellow pieces of paper and voilà, sticky notes.

I guess I really didn't know what I had, but I knew that someday I would find a use for it so like a packrat I put up a single chart off in the corner of my screen with the *rejected* Fibonacci-based moving averages. It was sitting there in between bites of my hogfish sandwich that I decided it was time to take those moving averages and see if they were my "sticky notes."

These Fibonacci-based exponential moving averages met the one criterion that I look for, objectivity. They reduced the lines and levels I had to manually draw on a chart, they were more accurate because they didn't involve any subjectivity, and they were based on Fibonacci numbers, which have an amazing way of getting the pulse of the way things in nature expand and contract. When you consider the subjectivity of manually drawn trendlines and the time it takes to identify and draw them across multiple pairs and time frames, you can begin to see what a significant improvement this can make in your analysis.

I also think that this is a perfect time to mention that while this book and probably about 80 percent of my trading is in the forex market, I use these same trading tools, philosophy, and entry strategies to trade stocks, ETFs, and futures.

## USING LAZY DAYS LINES

The Lazy Days Lines are simply the exponential moving averages set on the close of the following numbers:

55, 89, 144, 233, 377, 610, 987, 1597

Each number is basically a single exponential moving average set on the close, and you can plot these on each time frame you watch. They will take much of the heavy lifting from your charting analysis. Use these lines as you would any manually drawn support, resistance, or trendline because they are in fact dynamic decision levels.

Now it's not just that easy. The next step is going to be yours. The job ahead of you now is to train your eyes to recognize these lines when they are identifying support and/or resistance well; it's what I call *prices respecting the levels*. This comes over time and practice. That's why I call it training your eyes. You are likely not going to see the charts in the same way I do. Over the years my trading and analysis have quite literally evolved through repetition, allowing me to focus on recognizing the "right" cues quickly. With practice I'm certain you will get there, too. If I didn't truly believe that, I could never teach with the joy that I do. Remember, no one told me how to do what I am outlining in this book. For me it was trial and error. For you it will be recognition and practice.

Once you put these eight exponential moving averages on your chart, you will in essence have an automated support/resistance study on your chart, any chart, instantly. Add to those Lazy Days Lines the market cycle indicator of the Wave and psychological numbers, there is little more you have to do manually to your chart(s) other than make sure your market memory is correct for the time frame you are looking at. This all goes back to the foundation of Forex in Five trading. Quick, reliable, objective tools and analysis are the core of this trading approach and overall philosophy.

Think of Lazy Days Lines as an alternate for support, resistance, and trendlines. I think that it's a quick and easy way to find levels to watch on any chart. While they may not be perfect, they are objective, and there is value in that, since uptrend lines, downtrend lines, and horizontal support and resistance that are drawn at the trader's discretion can carry bias and are open to user error. If you are long the market, there is a tendency to see the charts in bullish terms and vice versa when you are short. Lazy Days Lines can also give you insight into the trend of the time frame they are plotted on. When the market is strong, prices tend to trade above the Lazy Days moving averages, and when the market is weak, they are usually below.

You'll also notice when you start laying these moving averages on your charts, how often Fibonacci levels will coincide with the Lazy Days Lines. Again, when you see a certain price with multiple studies pointing to its validity as support or resistance, it just strengthens that level that much more.

The validity for these lines can be strengthened by psychological levels as well. In fact, really any support and resistance level that lines up with the 00, 50, 20, and 80 pip levels fortifies the strength of that support and



resistance that is likely to be there. I like Lazy Days Lines for their simplicity and reliance upon a series of numbers that I already have great trust in. Truth is that you are not likely to develop the kind of confidence in these levels that I have until you take the time to set them up, observe the support and resistance they offer, and basically see them at work. This takes time and observation. In fact, the confidence to begin relying on Lazy Days Levels can begin and should begin with the Wave.

## THE WAVE IN ACTION

I now want to show you a couple of practical examples of how I incorporate Lazy Days Lines with the Wave by using the following charts as our reference points.

This is basically the Wave/CCI set-up and is an entry style that I have been using for almost 15 years. The difference now is that I am trying to make it more step by step with fewer discretionary items to consider (e.g., Wave clock angles, price).

So you have the Wave: the 34 EMA on the high, the close, and the low. What I have done, mainly for my own purpose here is to replace the Wave with colored candles. A green candle is a candle that has already closed above the top line of the Wave, the blue candle is one that has closed within the Wave itself, and the red is a candle that has closed below the bottom line of the Wave (see [http://raghee.com/Home\\_ForexinFive.htm](http://raghee.com/Home_ForexinFive.htm) for colored charts).

The entry trigger is a candle that breaks up through the top line of the Wave (buy) or a candle that breaks down through the Wave (sell). Blue candles are alert candles as they are neutral and that would mean they signal that a trigger could be coming. Blue candles will most typically occur during the sideways market cycle or during an uptrend pullback or downtrend bounce.

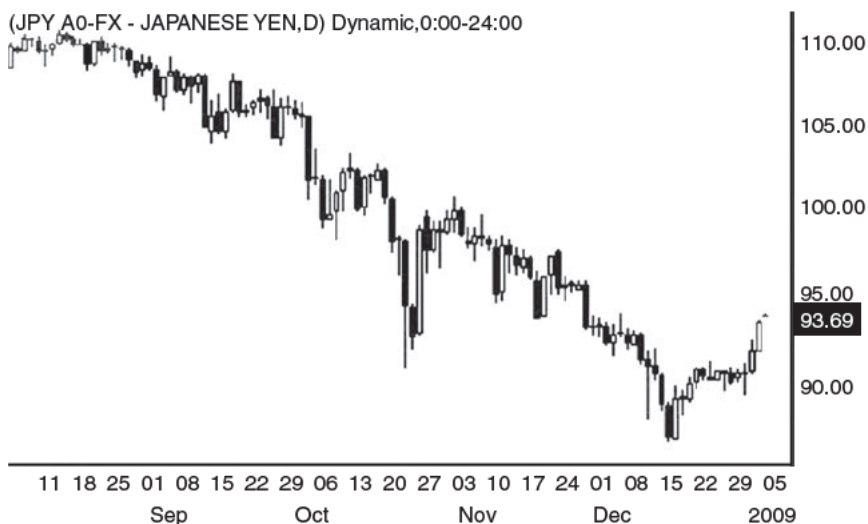
So you see that the basics are the same ideas that I have used and taught. I think what makes it interesting is that this is completely visual.

I think that in the interest of keeping this basic system, well basic, is to consider only major and minor psychological numbers, which are completely objective, or even pivot points, which are almost completely objective. (By the way, it's time that makes pivot points subjective as different traders can use different closing and opening times.)

Enough talk, let's look at Figure 5.1. I call these charts "GRaB" charts (Green, Red, and Blue).

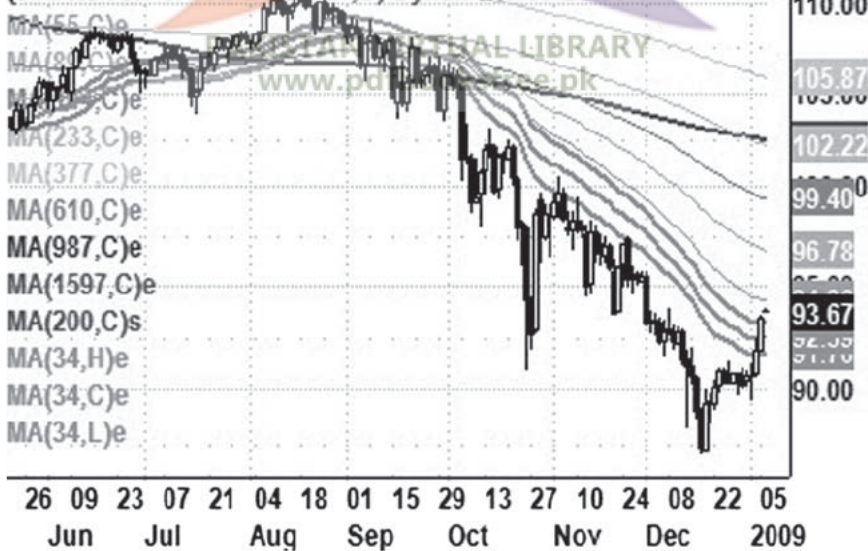
Notice there is no noise. None. The downtrend would look like Figure 5.2 on one of my typical charts with the Wave and Lazy Days Lines.

(JPY A0-FX - JAPANESE YEN,D) Dynamic,0:00-24:00

**FIGURE 5.1** A "Naked" USD/JPY Daily Charts

© eSignal, 2008.

(JPY A0-FX - JAPANESE YEN,D) Dynamic,0:00-24:00

**FIGURE 5.2** The Same USD/JPY Chart as Before with Lazy Days Fibonacci Lines

© eSignal, 2008.



There's more information here but that's also what can take a lot of traders off the fairway and into the tall grass.

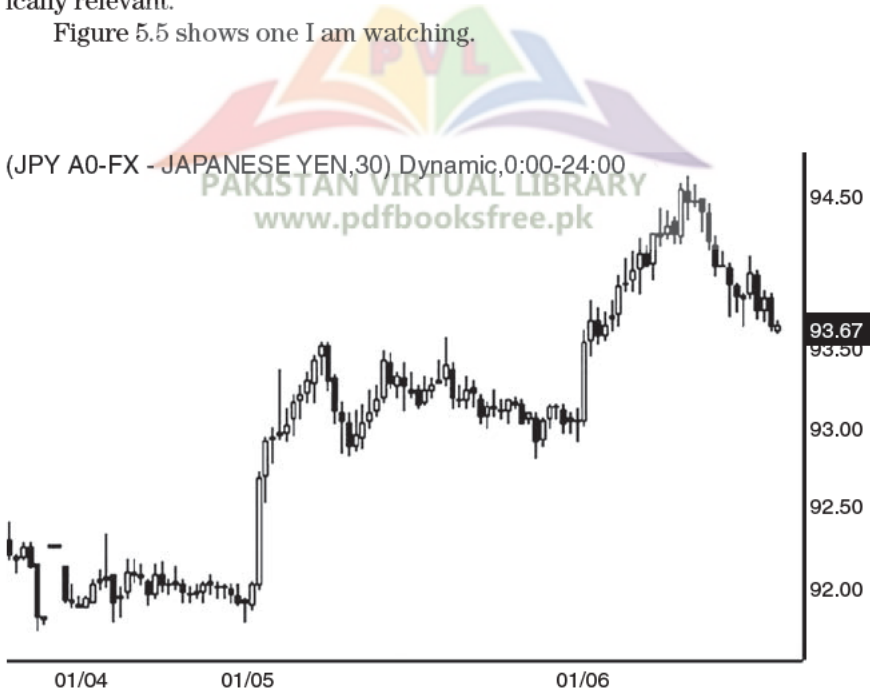
The set-up is a classic Wave/CCI but the trigger can look cleaner when all you are looking for is the green candle; green again simply indicating that prices have broken the top line of the Wave.

What makes this set-up even better is the blue (neutral) candle in between and that's the pause we would look for in the Wave/CCI set-up as the market cycle goes to two to four o'clock. See, this should already feel a bit familiar. We're taking advantage of a breakout to the upside as signaled by price breaking up through the Wave.

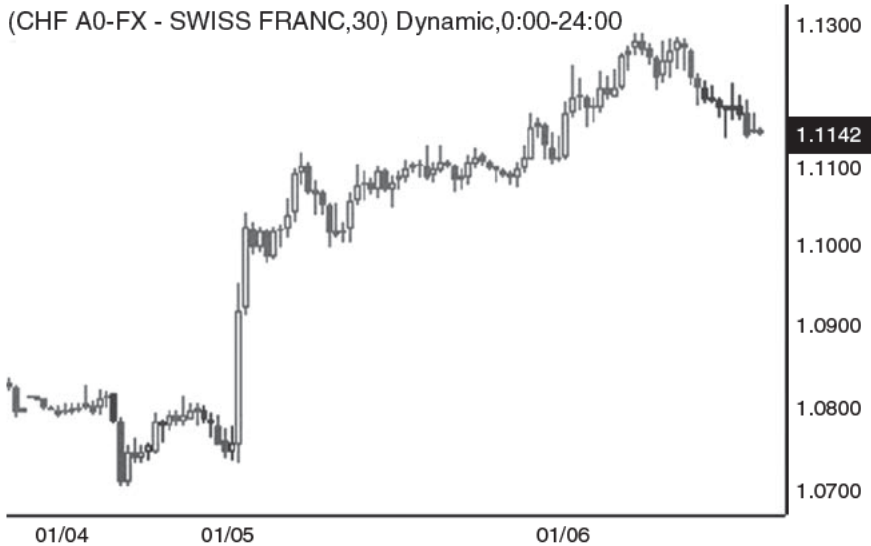
Frankly, my eSignal plug in has done this candle coloring since it was first introduced at the eSignal website six or seven years ago. Obviously it's just a visual cue . . . just an aesthetic tool.

Here's a few that are setting up right now on the 30 minute USD/JPY (see Figures 5.3 and 5.4). I will say that I like this set-up better on longer term (especially daily!) chart versus intraday. But then again, almost everything works better on end-of-day charts as they are the most psychologically relevant.

Figure 5.5 shows one I am watching.



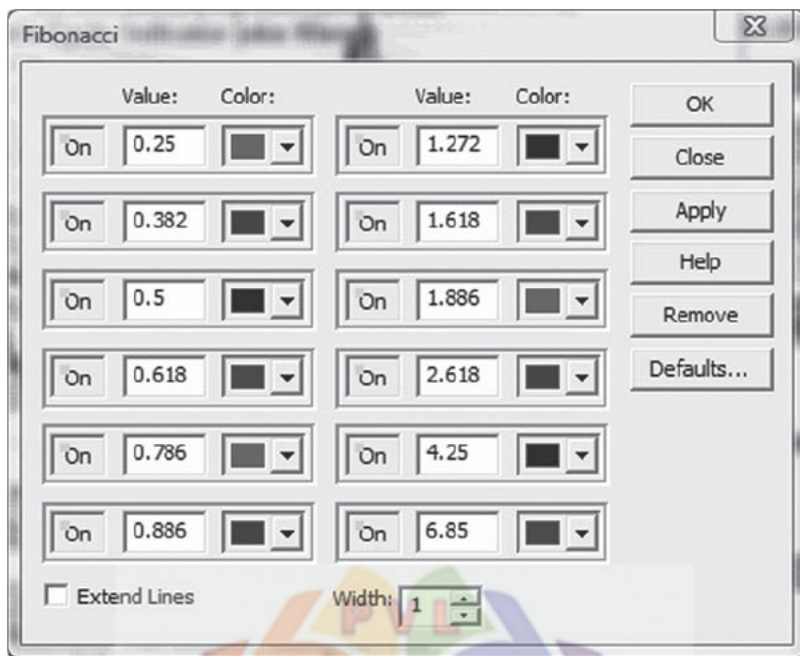
**FIGURE 5.3** 30-Minute Intraday Chart of the USD/JPY  
© eSignal, 2008.



**FIGURE 5.4** 30-Minute Intraday Chart of the USD/CHF  
© eSignal, 2008.



**FIGURE 5.5** Daily Chart of the EUR/USD also Known as the "Fiber"  
© eSignal, 2008.



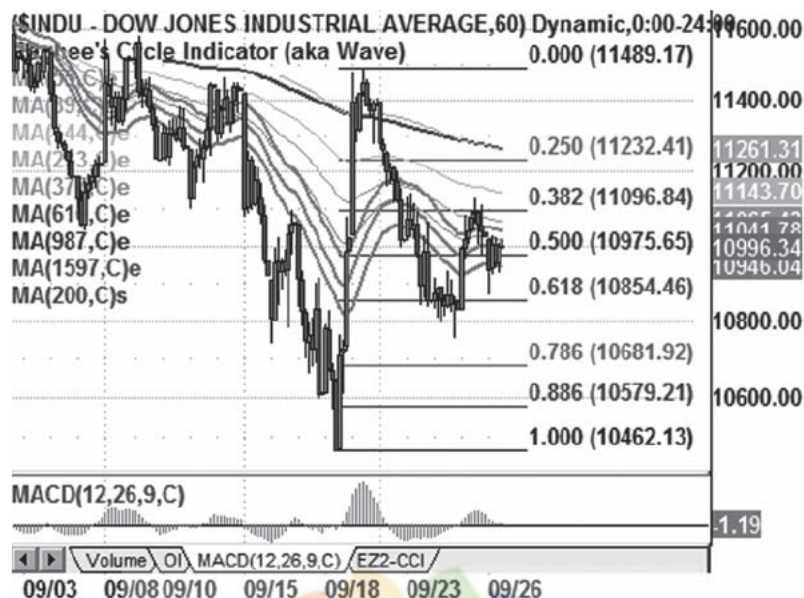
**FIGURE 5.6** The Fibonacci Percentages I Use Shown on eSignal

Let me also share the precise levels with you here so you have a resource for the settings I use on my Fibo levels. Just remember that Fibonacci Levels are either loved or loathed. It's a subjective tool which does require a certain amount of experience and practice to use but once you "get it" you'll not want to trade without it.

The levels I use are listed in Figure 5.6. Not all platforms will give you this much customization over your Fibo levels. I think it's important to have these levels on your charts when there is a viable "last major move" from which to draw them from.

You'll seldom find yourself in a situation where you are consistently using the higher extension levels (2.618, 4.25, 6.85) and if you do, you're using last major moves that are too small.

Now if you choose to use Lazy Days Lines, you will find that there will be useful overlap between the Fibonacci levels and the LDLs. It's easier to use LDLs but I don't want them to divert your pursuit of improving your Fibonacci Retracement/Extension drawing skills. In Figures 5.7 and 5.8 you will see the direct correlation between Lazy Days Lines and Fibonacci levels.



**FIGURE 5.7** The Dow Jones Industrial Average with Lazy Days and Fibo Levels  
© eSignal, 2008.



**FIGURE 5.8** The U.S. Dollar Index with Lazy Days and Fibo Levels  
© eSignal, 2008.

## REAL-LIFE LAZY DAYS LINES

Start with the market cycle. I am looking at the cable on the 180 and 240 minute time frame. This is how “triage” begins. .Initially I am comparing the quality of the market cycle (see Figures 5.9 and 5.10).



**FIGURE 5.9** An Example of a Three O'clock Wave Angle on the 180 Minute GBP/USD  
© eSignal, 2008.



**FIGURE 5.10** The 240 Minute GBP/USD. Compare the Wave Angle to the 180 Minute Chart  
© eSignal, 2008.





**FIGURE 5.11** Look at the Line Drawn Extending the Middle Line of the Wave to Indicate the Angle  
© eSignal, 2008.

The 180 minute chart has a slightly flatter, more three o'clock Wave. Perfect for a momo set-up. The term "momo" is short for momentum trading. Momo or momentum trading is the style of entry used when trading a narrow, rangebound market. This market cycle is accumulation and is identified by a three o'clock Wave. The 240 is transitional. The 180 wins this one with the flatter Wave.

Now it's time to find some support and resistance to play a breakout or breakdown through. See Figure 5.11. The uptrend line is drawn manually and this would be the support I will be watching for a breakdown. The other two lines (light blue and light purple) are the 144EMA and 89EMA respectively. I simply extend out the direction of the moving average to create a Lazy Days Line.

From here, set-up a momentum trade. Use the MACD Histogram to confirm the break (it's currently below the zero line right now).

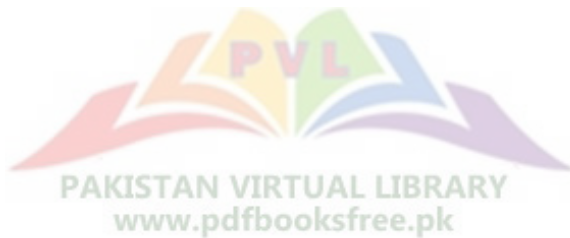
## COMPREHENSION + CONFIRMATION = CONFIDENCE

I am talking about putting the three Cs to work as it applies to the Fibonacci-based moving averages. I think in the past couple of pages I have sufficiently explained the exponential moving averages settings and why I chose Fibonacci numbers for the settings.

I am going to begin transitioning to the confirmation—to training your eyes to recognize the use of these Fibonacci-based moving average lines. The best way to do that is for me to show more and more examples of set-ups with my Lazy Days Lines which I will do throughout the rest of the book.

What you need to keep in mind is that the lines are not the only considerations for key levels and trade entries. Don't neglect the major and minor psychological levels and the "on/off" indicators for trade confirmation. Remember that these levels must be used in conjunction with market cycles (as indicated by the Wave) and the four set-ups we watch for: momentum, swing, reversals, and inside the range.

Lazy Days Lines are still in harmony with my overall view that all trading is essentially the process of recognizing support and resistance via whatever set of tools you use and then determining what to do with these decision levels depending upon the market's direction.





## CHAPTER 6

# The Only Entries You Need



**Everybody has an opinion . . . but *they* are not trading *your* money, are they?**

2006 "Fxstreet.com. The Forex Market." All Rights Reserved.

**W**e spent some time earlier discussing that you should not define your trading by your entry strategy and that how you enter the market is dictated by the underlying market cycle. Accumulation, distribution, mark up, mark down cycles each have a strategy that is appropriate to handle the price movement that created the cycle. So the first question that you ask yourself as you begin looking at any time frame of any market is *What's the market cycle?*

If you don't answer this question, you are applying a completely random strategy to the market. This most oftentimes explains why sometimes your strategy works exceptionally well and other times it seems as if you are dancing to a completely different tune that is not in sync with the market. Remember that the market moves because at any given price there is a buyer and a seller willing to do a deal. Whether you are the buyer or whether you are the seller depends upon your trading plan, which is dictated by the underlying market cycle. That's it!

Since there are only four ways in which the market can move, there are essentially only four trading entries you need: one to handle each market personality. Let me add that the four I use are not the only ones that exist, nor are they the only ones that you have to use. They are simply the ones that I prefer. Of course, I do feel they are the best, that is, the best for me and the way I view the market. Right now, accept that there is no best strategy, no best time frame, no best forex pair. You are only looking for what is best for you, and that is a very personal thing. Account size, risk tolerance, experience, when you decide to trade, the volatility of the current market, and economic data releases are just a short, but focused list of considerations.

I realize that you may already have some strategies that you know well and employ. Perhaps you are having a hit or miss relationship with the market like many traders. The first thing you need to determine about your current strategies, or any strategy you learn or use from this day forward, is this: What market cycle is this strategy designed for? It was developed for a specific cycle whether you know it or not. Your first job is to make sure you know when to use it because bottom line: There is no single entry strategy that will work in every market environment.

*Remember that applying a strategy is not a matter of what I choose to employ but rather what the market cycle is demanding I use.*

## MOMENTUM TRADING

First, don't get too hung up on the name "momentum trading." It's an approach to the market that describes what type of price action you are trading. In this case, you are looking for momentum, specifically momentum from a range-bound, sideways market. There are many forms of momentum, but it is essential that you understand that I am describing momentum from a specific market cycle, mainly accumulation.

Think about the psychology that creates accumulation. Most often it will be uncertainty or anticipation, sometimes both. Think about the way

the market reacts when there is an impending economic data release. I don't know what the actual result will be, my guess is that neither do you. So what do you and I do? We look at the consensus or forecast number; we consider how the actual number will reflect against what has been baked into the cake. This creates a narrow range-bound movement until the report is out and the number is known. That reaction, the reaction to the known, creates momentum. We want to be on the right side of it. That's one common scenario.

Knowing this is not enough, but it's a good start. This movement has to be measured against price. Price creates touchpoints; and touchpoints create uptrend lines, downtrend lines, horizontal support, and resistance. Price also is what allows our indicators, like Lazy Days Lines, to plot. Price is everything. This concept of price being king isn't just applied to momentum trading but to all entry types.

There are four simple steps to momentum trading, but I have to add that the homework must be done first. This means that you should already be aware of any relevant trendlines or horizontal levels that could be in play. You could and should use Lazy Days Lines to speed up and simplify this process. Add in psychological levels to the mix, and you will have a good look at where the entry triggers are waiting. For momentum trades it's all about a shift in psychology, which also clues you into the shift of power. These shifts occur at decision levels. Bulls and bears are always making decisions as to where they want to buy or sell. Charting and price action is all about locating these levels, and it has as much to do with price itself as it does with the psychology behind the price.

Momentum trades take you from a balance of power to an imbalance. All breakouts and trends represent imbalance. Who are we watching (bulls, bears, buyers, sellers)? It's Economics 101. Supply and demand. Too much supply—not enough interested buyers—and prices move lower. Too much demand—not enough willing sellers—and prices move higher. When both the buyers and sellers don't do anything, you get balance and that's an accumulation market cycle. At some point this balance will be shaken. The two main questions are when will we get involved, aka trade? The other question is where, at what price or decision level, do we recognize the shift or imbalance? That's the entry price.

The entry in any trade must be based on price. This does not negate fundamentals as a potential sentiment or timing tool, but let's get real. For every bullish fundamental out there, there will be a bearish one. Which one is discounted? The easiest answer is the forecast number. Entering momentum trades must be done before the actual number is reacted to. Have you ever tried to enter a market during economic releases? If you have, then I don't need to tell you what a typically difficult or aggravating order it can be. Here's the breakdown for those of you who never have.

Imagine sticking your hand into the spin cycle of your washing machine. I said *imagine*, don't do it! Within the blur of clothes spinning by at dizzying speed, pick out your favorite T-shirt in the load. And that is what it will usually feel like to get your price with a high-impact, volatile economic report release.

This will not always be the case as all economic releases and news do not have the same type of impact. Many times the actual result will not vary much from the expected forecast number, and in those cases there is likely not to be much movement or momentum. It's like my first jiu-jitsu told me: Don't expect an anatomical response. "If I teach you to punch first, then kick, then throw, do not assume that your opponent will react in an expected way. Notice what is working, how your opponent is reacting, and adjust." In this case, don't expect the market to do the expected. It usually doesn't.

So it's back to price. Think about what resistance or a downtrend line are. They are created by sellers or a shift of balance from buyers to sellers. A ceiling or resistance is created when buyers are no longer willing to pay more and sellers are willing to sell for less. Take that same thinking to support and uptrend lines. Buyers are willing to pay more; sellers are all too willing to sell for more. What's the price these two groups are doing battle at or around? That's exactly what you need to identify because when you do, you know exactly when the shift will occur. Even before the data is released, you will know this battleground better because it's the decision level.

You see that's where most traders let the wheels fall off the wagon. They react to the volatility without defining the direction or the movement. Keep in mind that all this is relevant only when the market is going sideways to begin with. In a trend it is an entirely different psychology and entry. *Momentum trading is all about putting yourself on the right side of the market before the momentum reveals itself.* There is some anticipatory action that needs to be taken because the whole point is to already be positioned on the right side of the market, not necessarily be in the rampage of the herd when everyone knows and is reacting to the news. So, yes, I am going to show you how to pick a side because waiting for momentum to reveal itself sounds good in theory but it is difficult to execute with consistency.

This brings me to order entry and execution because all charts and no order entry make for ... nothing! You can't get anything done without actually executing an order in the market. There has to be a bridge from charting analysis to real-world order entry and execution. Order entry is all about knowing what you are going to type into your brokerage's trading platform. Order execution is actually getting your price filled. You can enter

orders until your fingers go numb, but without getting those orders filled there is nothing taking place.

Filling trades (and this will also apply later when we discuss the other trading types) involves some forethought. Many traders place their orders and enter their trades in a knee-jerk manner. They are always operating in reactive mode not because they necessarily want to but they don't have an alternative.

**Indicators.** *They indicate.* As an English major, I feel it's my responsibility to tell you that "indicate" means "to point out or point to" or so says Merriam-Webster (<http://www.merriam-webster.com/dictionary/indicate>), so let's use them in that capacity. This is especially important when entering momentum trades. Again, remember that most traders are scrambling for entries at precisely the same time that many other traders are trying to do the same. This is why you see candlesticks that look like skyscrapers on your charts from time to time. Getting your price in this environment is difficult at best and aggravating for sure.

What are the options? First is not to trade during these times, during economic releases and unscheduled events. Second is to already be in the market. I'm going to show you how to do both. The key here will be using a simple MACD Histogram set on a 12, 26, 9 which is the most popular default (check your platform) and make sure it's Simple Moving Average (signal line) calculation (again check your platform, for example, on eSignal this setting is an option and you simply check the box; alternatively on Metatrader 4 it's called the Oscillator of the Moving Average). The MACD Histogram will be used as a filtering tool for entries on momentum trades, and momentum trades only.

This indicator will act not only as a filter but will allow us to place what I call "proactive" orders. This means that we can park stop orders in the market and the order(s) can sit and wait for the price to trigger the entry. Using an indicator like the MACD Histogram allows us to visually filter out entries that are likely to not follow through. In situations where the MACD Histogram is already above the zero line, I will consider a momentum entry "preconfirmed," which means that an order to capitalize on a break to the upside through resistance can be placed at the trigger price. If the MACD Histogram is below the zero line, then breaks to the downside, a short, is preconfirmed and you can place the sell stop at the trigger price. Will all trades be preconfirmed? Of course not. But a big part of trading is knowing when to do nothing and be flat, even when price may be moving.

So is the MACD Histogram—any indicator for that fact—going to point to the direction of the move? Sometimes, but not always. But what it will do is allow you to filter out moves that are less likely to follow through. A simple break of price is not enough; we need follow-through. The hope

is that we will get follow-through on all our trades because we have accurately identified the price level at which the shift will occur. But there has to be some consideration that the spot picked is not the shift point or that it was a smaller shift along the way to a larger one. And guess what? There may be price levels that are bullish shift points that are located just below a bearish one . . . that's the way support and resistance work. It's not always clear sailing to the profit target.

No trade should be reactive, because that response is usually one that is not planned and is almost always emotional. The more you can choose a side that is most likely to have follow-through, the better off you will be when playing sideways markets.

There are four simple steps to each entry type. Why four? It works, it's a nice even number, and frankly, I think five steps would be extraneous. So here they are—the four steps to momentum trading.

1. Start with the three o'clock sideways Wave. This is a must. If you start off with a bad market cycle reading, everything else is built upon the wrong foundation. Remember that give or take a few lines and levels, if you were to pass a chart around the room, there would be similar lines that are identified by most people. The difference is what each individual does at the lines. Market cycle readings will dictate whether you buy or sell resistance, support, uptrend lines, and downtrend lines.
2. Identify the shift points that could be entry triggers. Remember that you can use Lazy Days Lines; psychological levels; the Wave; and manually drawn support, resistance, uptrend lines, and downtrend lines, although you want to keep this to a minimum to avoid the subjectivity of these lines and levels.
3. Once you have recognized your potential entry triggers, you'll see that most momentum trades have both potential buys and sells. There are certain factors that you can use to determine which of the many possible triggers could represent the best shift and therefore have the best change for follow-through. I like to see overlap, that is, an overlap of a psychological number and a Lazy Days Line or overlap of a manually drawn line/level and Lazy Days Lines or psychological level. The more overlaps, the more likely a broader and bigger group will react creating more imbalances. But that is not a guarantee, and neither do we know which direction movement will be in so, we must filter the movement.
4. Filter the shift, which means that when price move through the decision level, as the balance between buyers and sellers is gone, you should look to filter the move with the MACD Histogram. This is how I can place proactive orders, park them in the market, and let the price come to me. I won't and don't chase price. I don't wait for the candle or



bar to close. It will be price movement through the trigger and then visually confirmed by the MACD Histogram that will complete the entire process.

Remember, if the MACD Histogram is preconfirmed it will already be visible on one side of the zero line or the other. If the bars of the histogram are tall, then there is less chance that the confirmation will be lost, and you can park your stop order with more confidence. If the Histogram bars are short, however, or bobbing from positive to negative, then you'll want to bracket the trade, which means park both a buy stop three to five pips beyond the resistance trigger and park a sell stop three to five pips below the support trigger.

When a momentum trade is setting up in front of an economic release, then you are basically running out of time, because I do not want you under any circumstances to enter a momentum trade with the release. This brings us back to the washing machine and the spin cycle. In fact, ideally what you want to be doing during the volatility of the release is twofold. First, you are going to utilize what I call a "60 second stop" so that you are not using a price-based stop which could easily be hit during the release only to reverse sharply. Second, the 60 second stop is a time-based stop predicated upon the likelihood that most data events take about one minute to settle down and thus a time-based stop would better suit the psychology of that particular price action. You will, however, be sure that your profit target order is already parked and waiting to be hit. The profit target order will be a more easily filled execution as you will be executing your order into the push of buyers and sellers. You will be in the minority rather than the majority competing for the fill.

There are a number of factors that go into any trade being entertained and entered. When I talk later about the concept of triage, we will talk more about prioritizing potential trades and comparing the quality of trades that should in effect be competing for our attention and trading margin. I've detailed one of four entries, this one being the entry of choice for setting up and entering breakout and breakdowns from sideways markets. Let's talk about how to enter trending markets next.

## **SWING TRADING**

Trend following is enjoying a bit of a comeback as of late because like everything, if it is able to hang around, it will be back in fashion. The funny thing is that swing trading or trend trading—they're the same thing—never really went anywhere. They're just coming back with new names. Swing



or trend trading allows a trader to enter a market already heading higher or lower. Problem is there is this nonsense about swing trading being a trade that is held for three to five days or something like that. Am I being dismissive of this definition? Am I scoffing, if not rejecting, the idea of a trade being held simply because a certain number of days have passed? Absolutely.

Swing trading is based upon identifying an uptrend or downtrend and waiting for a correction in the trend to enter. Now if you are still hanging onto some time-based definition of swing trading, let me ask you this: If you enter a swing trade on a 30 minute chart, how long do you hold on the position for? How about a daily chart? Trend following can only be done in an established trend. Can we agree upon this much? If so, let's keep moving on.

Let's get into the details of how to set-up a swing trend. First identify the trend and that's as easy as finding a twelve to two o'clock Wave for an uptrend and a four to six o'clock Wave for a downtrend; these are the markup and markdown cycles respectively. That's the first step, but by now you know this is also the most important one as well. Second, and here is where you'll have some decisions to make, is identifying the corrections. Corrections are going to be bounces in a downtrend and pullbacks in an uptrend. When the market dictates that you swing trade, your job is to buy pullbacks and sell bounces. The charts and price action will help you determine what exactly the bounce or a pullback is and when to act.

Remember that you will already have a number of lines and levels on your chart: psychological levels, Lazy Days Lines, and any uptrend, downtrend lines, and horizontal levels you may have manually drawn. For the purposes of swing trading these lines and levels are not as important as they would be if the market were traveling sideways and you were momentum trading. Swing trading the way I do it is very simple in its set-up, but can try your patience in its execution.

The psychology of a trend is imbalance. Buyers and sellers are doing battle at those shift points/decision levels. It's the psychology of a trend that makes for the heightened emotion. People getting greedy in an uptrend, people getting fearful in a downtrend, people fearing they have missed an opportunity in an uptrend, people fearing that things could get worse in a downtrend. The fundamentals that feed a trend are varied. In fact, sometimes the reasons come after the move, not before. People tend to look for the reason afterwards to justify their position when the excitement lured them in. But the psychological reasons are typical and predictable. In fact, it's another fairly reliable feature of a trend that makes swing trades possible.

Trends have groups or waves of participants that move into and out of the market. Trends usually have three groups that make their way in

and out based on their type of participants. You have your pros and insiders, your speculators, and finally your latecomers. Pros and insiders are the first to be in the market; in fact, they are likely to be the ones that get the market out of accumulation and moving higher or lower. As prices move higher and fundamentals supporting the move become more widely known, speculators will enter. The reason most speculators enter is the movement itself. Speculators or traders seldom start the move, but they can certainly accelerate it. Finally, the latecomers make their way into the market, partly because they are gamblers thinking that they are missing a move, mostly because they are not well versed in the ways of the market, and especially because they are clueless. They are easily manipulated by the media, and this just makes the third group that much larger. But they are very important to the first and second groups that entered the trend.

The latecomers are essential to the pros/insiders and speculators exiting and taking profits. However, it's not as if there is a specific place where the first two groups will exit, but there are typically two to three significant pullbacks in a strong trend. The first pullback is the pros/insiders taking some profits off the table; they are not all out, but they are not all in any longer either. This is where most speculators will enter. Of course, there may have been some speculators that entered with the initial breakout/breakdown, which would be a momentum trade, so don't think this clicks along like clockwork. But one thing that we can rely on as Forex in Five traders is that human nature is nothing if not predictable.

The third group, the latecomers are the group that has watched the trend (up or down, but they are most predictable in an uptrend), and are now worried and ticked off that they missed most of it. Chasing an entry is in many ways a form of revenge trading. They get in haphazardly—and picture this—they are gobbling up the shares, lots, size of the first and second groups. In order to realize a profit in an uptrend, I need a buyer to take my offer. Now imagine a huge size, I mean a really huge size and the amount of participation needed to exit and realize a profit. Sure, the market needs this last group to be out of the loop, and by and large they are. Smart traders who enter a trend do so only when they can get price improvement, and that means playing the corrections.

Entering corrections on the surface may seem contrarian, but only the entry order is. Trend following is not. It may seem uncomfortable to buy short-term weakness, a pullback, in an uptrend or sell short-term strength in a downtrend, but remember it's short-term within the context of a longer-term move. The main issue at the heart of swing entries is knowing the difference between a correction and a reversal. This is done easily with taking the clock angle of the Wave and recognizing strong uptrend and downtrend Wave angles versus those that are transitioning to weaker angles. Again, use the market memory appropriate for the time frame, take

a clock angle reading, and it becomes a simple visual task. The great thing about the Wave is that you can not only identify a trend in its early stages, you can also use the Wave to see shifts—strengthening and weakening—of the trend.

The easiest way I know to enter a trend is to use the Wave itself as the entry level. In an uptrend that means using a pullback to the top line of the Wave as support and buying opportunity. In a downtrend, use the bottom line of the Wave as resistance and a shorting opportunity. The three 34 EMAs of the Wave are dynamic support and resistance, most especially within the context of a trend, as any moving average would be.

Using the Wave as an entry point is not your only option, but I think it's your best, and it's likely to be the most conservative in most cases. Conservative, meaning it will represent the deepest corrections as compared to psychological numbers, Fibonacci retracements, and pivot points. These are all valid options, but keep in mind that the Wave and psychological numbers are objective. Pivot points are objective in their calculation but in that there must be an imposed open and close on the session, there is subjectivity in what time a trader imposes that artificial open and close. (By the way, use 2 A.M. Eastern Standard Time which is 7 A.M. in London for the open and noon EST, 5 P.M. London, for the close.) The Fibonacci retracement option is a good alternative if you are confident in your ability to identify the last major move, but of all the alternatives, this is by far the most subjective. So that brings us back to the Wave and psychological numbers. So here are the four steps to swing or trend trading.

1. Begin by identifying a trend. This means a twelve to two o'clock Wave for an uptrend or a four to six o'clock Wave for a downtrend. There are some considerations when it comes to making this identification. Think of these as the visual nuances that I would like you to start noticing. There are angles within the trend that will point to weakness or strength. If an uptrend is moving closer to a one o'clock angle or even twelve, you're looking at a sharp uptrend. If it's closer to two o'clock, it's as weak as we'll allow the definition of an uptrend to be before calling it transitional and potentially a distribution market cycle.

Don't overload yourself here. If the clock angle is right and you're taking the reading from adequate market memory, then trust what you see. Eventually you will begin to see the nuances in the quality of the trend and recognize the little bumps you will see in the Wave as price action fluctuates.

2. The next step is to determine just where you will define your decision level. This is your pullbacks or bounce. I would say the Wave would be the first place you should start, and this is for two important reasons. First, and I think the most obvious, is that it's fast, objective, and easy.

Second, and this is the better reason, is that the Wave itself defines the trade, it can be the entry cue, and it represents the validity of the trade. Validity, this is the first time we've brought this up. It won't be the last, but I would like for you to start wrapping your brain around this concept: Stop losses are the point of validity.

In the case of swing or trend trading, the Wave is the point of validity, which means that if you are getting long at the top line of the Wave in an uptrend, if prices break the bottom line of the Wave, game's over. That means the reason for being long in the first place, the support of the Wave, is no longer valid. If you look to enter more aggressively, you are in effect increasing your risk in the trade. Now there are times that getting into the trade ahead of the Wave makes sense. One scenario is using "00" or "50" pip levels. The closer to the Wave these psychological levels are, though, the better. It is a balancing act, and there is no single "perfect" or "right" place to enter. Think of it more as aggressive versus conservative. There's a potential price to pay in each approach. Too aggressive, and you will get in too early and increase your risk sometime unnecessarily. Too conservative, and you could miss the entry altogether.

By the way, if you do choose to use Fibonacci levels, my advice is to use at least a 38.2 percent retracement and better yet a 50 percent. Do not use the shallow 25 percent, as it simply will not represent a significant enough correction to position a entry within the trend.

3. Now here's the hard part. *Watch and wait.* Prices have to come back to you, and when the market is trending, psychologically, it is much different than waiting for a breakout or breakdown from a range-bound market. You're going to feel like chasing the trend, but the smart money is either already in the market or waiting for the correction. There's another psychological trap when it comes to trends, and that's another form of revenge trading that is unique to trends, and that's picking tops and bottoms.

When you miss an entry, the easiest trap to fall into is waiting for the move to reverse. I see two reactions to missed trends most commonly, chasing the trend rather than waiting for it to correct and trying to pick a top or bottom. There are ways to do each, but there are strategies and rules to each. The only way I "chase" a trade is actually to wait for a minicorrection. I don't use this often, but I think sharing this will at the very least give you some structure. It's the four candle average. Here's how it works.

In an uptrend, you are going to take the last four lows of whichever time frame chart you are looking to enter. If it's the 30 minute chart, then you are looking at the last four 30 minute candle/bar lows, add them up, and then divide it by four. If it's a daily chart, you are going to

take the last four daily candle/bar lows. In a downtrend you are going to take the average of the last four highs. Once you have that number, the last four highs/lows divided by four, that's your entry price. Use a limit order and wait to see if prices come back and trigger your entry.

Top and bottom picking can be done with the Quick Transition/Short Cycle Set-Up I'm going to discuss next. It can also be done with Darts, Dow 1-2-3's, and M or W patterns. These are what I refer to as patterns within patterns because you will often see Dow 1-2-3's within a triangle or double top or bottom. Darts can be the touchpoints that make up a trendline or support or resistance line. Ms and Ws are often the shape double tops and bottoms take.

4. All swing trades are valid and preconfirmed just as long as the clock angle indicates that the trend is intact. Place a buy limit or buy stop order in an uptrend at the price of the top line of the Wave. For a downtrend you will place a limit or stop order to sell short at the bottom line of the Wave. Remember that each new candle/bar will likely change this entry price by a few pips so keep that in mind, especially if you are setting up a shorter term, intraday time frame like the 15, 30, or 60 minute charts.

The success in trend following is based on—yes!—trading in the direction of the trend. So whether you call it swing trading or trend trading, the bottom line is that it's not the entry strategy but the market cycle that dictates what you should do.

Think about it this way. If I were to give a group of traders a chart and each one of them could mark the dynamic and static support and resistance levels on it, I would have to say that give or take some lines, the results would essentially be very similar. So it's not the decision levels that separate traders' actions. It is what we do at resistance and what we do at support that differentiate what type of action we take. In order to swing trade, the first step is to visually confirm that the Wave is heading up at either twelve to two o'clock or that it is heading lower at four to six o'clock. If you start with the correct market cycle, in any sort of trading, you have immediately increased the likelihood that you are going to make the correct decision at the levels you are watching on your chart.

## SHORT CYCLE SET-UPS

Consider that there are going to be times when our momentum and swing trades are simply not going to follow through and the trade will fail. *Way to start this on a high note, Raghee!* That's what you're thinking, right? Well, it's a fact. There could be a number of things that either went wrong

or price action just didn't move in the direction and with the force that we expected. It's all part of trading.

We know that the market can move up, down, and sideways; that's it. The market can only move in these directions, so there are really just a finite number of options we can entertain in each individual market cycle. The cycles do not follow a set rhythm or pattern, so you don't want to expect a sideways market after a trend or assume that a downtrend can't simply and sharply reverse into an uptrend.

Quick-transition or short-cycle set-ups capitalize on those market cycle patterns where trends reverse without consolidation or congestion. In other words, there is no accumulation or distribution cycle, the market just reverses. There are a number of ways to play reversals depending upon price action. The easiest set-up to capitalize on trend reversals is what I call a Wave reversal entry or a Wave/CCI entry. I could actually call the next two entries we're going to discuss "Failed Trades" and "Capitalizing on the Market's Moodiness."

The simplest way to recognize a Wave reversal set-up is a failed swing trade, although it's not exactly the most enjoyable way, and neither is it the only way. When a market is trending, entering on a correction would trigger a swing trade. Sometimes that correction keeps right on correcting and breaks the opposite side of the Wave thus making the swing trade invalid: (1) We're stopped out of the trade, and (2) the trend has reversed. With certain preconditions I am going to explain, there is a chance to take the lemons of a loss and make lemonade. I love lemonade.

When a swing trade fails it also signals that the trend, as defined by the Wave, is broken or, as I mentioned a moment ago, *reversed*. With this shift in psychology, backed by price action, there is ample reason to shift your thinking as well. This, I won't kid you, is one of the more difficult trades to pull off from a psychological standpoint because the entire reasoning for the trade stems from being wrong on the prior trade. Shifting opinion is not something human beings do particularly well, especially when they have spent some time convincing themselves and analyzing reasons to hold an opinion in the first place!

This is precisely the reason why all trades have to entail a point of validity-based stop loss. Without a concrete reason and price on the chart to determine "wrongness," there is little pressure on your psyche to change your original opinion. We can't shut off our ego, but there is some chance of rationalizing with it. Since a swing trade is defined as valid as long as the Wave angle is twelve to two or four to six and prices are not breaking the Wave in the opposite direction of the trend, we can find that spot on the chart and say, "That's where I get out because the reason for being there (Wave support or Wave resistance) is gone." When you define "wrongness" by a random 1 or 2 percent, or a fixed dollar amount, then there is little



reason for your ego to accept being wrong. That is exactly why most traders ignore their stops. Simple as that.

The steps to playing a quick transition or short cycle are more than just saying that you entered in the opposite direction of the prior failed swing trade. Much more. There are certain qualifiers that will put you on the right side of the trade more often. Start with the market's psychology, the external psychology. The best environment for this set-up is news-based and a somewhat fearful or uncertain market. The reason is that it is easier to change the collective market's mind when there is uncertainty—which usually stems from fear.

The most important qualifier that you will look for on the chart is a prior established trend, up or down, but it must be established. You will also want to further check that this rally or sell-off is on par with the past few moves. More specifically, what I want you to do is look at the past two or three rallies or sell-offs and make a mental note of their size on average. Were they mainly 300 or 400 pips moves? Maybe larger 700 or 800 pip moves? Whatever it is, the current move that you are setting up for a short cycle/quick transition should be on par with the kind of swings the market has been making. If it's larger, that's fine. What I want you to keep an eye out for is if it is smaller. If it is smaller, then it's not going to be a good choice for this set-up.

The next step is to see the swing trade getting stopped out or a two to four o'clock Wave. It will most often look like a rounded U or sometimes a pointed V-shaped Wave. This is the two to four. This market cycle is more easily defined by what it's not than by what it is. Quick fresher: A two to four o'clock Wave is too flat to be an uptrend or downtrend and too angled to be a flat three o'clock. What's left is the transitional two to four o'clock Wave. So now we know that the market is gearing up for a shift, psychologically and price-wise. That's what we're betting on—that underlying market psychology and the price action that reflects it. So we wait for prices to pierce the other side of the Wave, the opposite side of where it had been trading. If you are already there, that means your swing has likely been stopped out and now you are checking to be sure that the two qualifiers are in place. Now you can begin looking at the CCI (Commodity Channel Index) for confirmation.

I will say that you do have a choice in confirmation tools. I use the CCI in this set-up (and that's why you also see this set-up also referred to as a Wave/CCI) because it is more discriminating. It's choosier! The MACD Histogram that I already have on my chart for momentum trading will also work, but it's not as good filter as the CCI. The CCI confirmation for a short, which is triggered as prices break down through the Wave's bottom line, or 34 EMA low is a -100 reading. The confirmation then for the long would be prices breaking up through the Wave high or 34 EMA high and a +100 CCI

reading. If you are fine with the MACD Histogram, then you simply look at it the same way as you would for a momentum set-up: above the zero line for a buy, below the zero line for short.

## **INSIDE THE RANGE**

So far we have discussed ways to take advantage of sideways markets, uptrending and downtrending markets, markets that reverse quickly from one trend to another and now finally we will talk about what to do with wide-ranging sideways markets. This is the distribution cycle. It is similar to the Wave/CCI set-up in its environment, but the main difference between when you set-up a Wave/CCI versus an Inside the Range (ITR) is that an ITR does not have that on par rally or sell-off that precedes it. Rather there is a wide channel (typically at least 80 to 100 pips) that has a solid floor and/or ceiling. In this case we are looking at a volatile sideways market that is bouncing between support and resistance. Not flat enough to be a momentum trade, because it's not in a three o'clock accumulation cycle, and not trending enough to be an uptrend or downtrend. And because the prior trend was not on par with past moves, there's no viable Wave/CCI trend reversal entry to set-up.

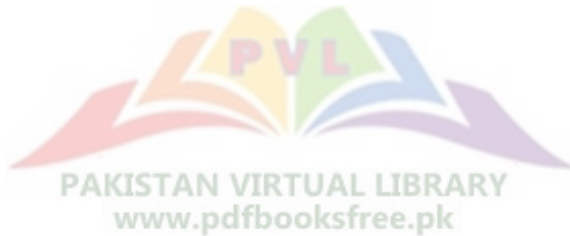
Inside the Range trades are always "aggro" or aggressive. That's because, even though the market cycle is range-bound, we're buying floors and shorting a ceiling. It's a top and bottom picking strategy from within the distribution cycle.

The easiest way to begin setting up an ITR is either finding the two to four or finding a solid ceiling or floor, or both, but both are not necessary. If you find a solid ceiling or floor, then you can begin looking to see if prices are heading up to test it. "Solid" is defined by the difference between the touchpoints forming the horizontal or "static" level being five pips or less. So if you have two touchpoints from which you have drawn a horizontal floor (support) and one touchpoint is, for example, 1.3065 and the other is 1.3060, it's five pips, and you have a solid level. If the levels had more than a five pip difference, you have a soft level. The softer the level the more difficult it is to enter and determine your point of validity. The more solid, the easier it is to pinpoint where the reversal off the floor or ceiling should occur.

These trades are agro, but the ITRs do have one large factor in their favor. The stop loss is always easy to determine. It's almost always going to be 10 pips, and that's because the reversal either happens right away at that ceiling or floor or it's likely not going to happen at all. The rationale for 10 pips is not a random one. It comes from the psychology that traders

will look at a 10 pip cushion between decade levels as an acceptable *wiggle*. Think about it. If you were short of a 91.72 level on the USD/JPY and prices went to 91.79, you could still look at that small move and say, “Well, it’s still in the 70s,” and you wouldn’t be alone. That is precisely what a lot of traders do. Remember there is a whole psychology behind numbers! Why is 40 such a dreaded birthday? Because you are now leaving your 30s! Price works the same way. So once 91.80 starts to trade, the psychology has shifted. So as I said, typically the most you will risk on an ITR is 10 pips because we use this psychology at the ceiling or floor we enter at.

There is no formal confirmation indicator for this set-up, although many traders have asked me to offer one, and the only one I grudgingly recommend is a 21, 1, 3 Slow Stochastic. But since this is such a price-based entry and one that is using the psychology of numbers in a way that keeps our risk low, I don’t believe the filter is necessary. More important, I don’t think it works as well as just using the floor or ceiling level itself. But if you want to experiment, use an oscillator, since this is a range bounce market environment set-up.



## CHAPTER 7

# Around the World



**Effective order entry will allow you to walk away!**

2006 "Fxstreet.com. The Forex Market." All Rights Reserved.

**L**et's preface this next discussion with the fact that many of us have attended one of the many traveling shows that come to our town talking to us about forex trading and the wonderful world of this 24-hour market. If you are expecting me to bash these, I'm not. If you were introduced to this market by some such presentation, well then, that was worth your time and you had the knowledge to go out and seek more knowledge, which no matter who it comes from, can be a valuable gift—if you know what to do with it. If you bought the course, software, book, DVD,

whatever, I'm quite certain no one put a gun to your head. So let's move on. It's a fresh start.

Two of the most compelling features of the forex and the ones most touted are the 24-hour trading time of the foreign exchange and the fact that it is the largest market in the world. Both in fact are true but exaggerated. How about the fact that there is always a bullish market in the forex? Also true, but you need to find the pair that is trending higher.

If you were to ask me what the biggest misconception most traders have about this market, the one thing that is completely overused and misunderstood, it's that this market trades 24 hours a day. *Now what a minute, Raghee, you just said that was true!* And you're right, I did. But let's clarify right now—all 24 hours are not created equal.

## WHO'S AWAKE?

This is the first question to ask before you put on a trade, before you begin your analysis, and is a key to understanding follow-through and order entry.

This was not necessarily a common train of thought for those of you who are making the transition to the forex market from the futures or stock market as I did back around 1999–2000. We knew when the market opened and closed; heck, they rang a bell to let us know! We knew what was an illiquid pre- and post-market, and we know when most of the volume occurred. For those of you not making this transition, you were wide-eyed listening to the speaker explain how you could come home, hit a few keys, look at the market, and execute your trades before heading off to work or after dinner. Well, it's not untrue, but it's not the whole story either.

I'm sure you've heard about your buddy or a friend of a friend who gets up at 2 A.M. EST to trade the markets as Europe and the U.K. begin trading. And now you're thinking 2 A.M.? I can't get up at 2 A.M.! Well, here's the skinny. I don't, and you don't have to either. It's a choice you can make, and heck, if you live outside the United States these may very well be your regular trading hours, but for most traders in the United States it's a frighteningly early part of the morning reserved for new parents whose newborn still doesn't sleep through the night.

By the way, I have received many e-mails from new parents who have said that getting up with their baby is a great way to trade the forex. All I say to that is you can never start teaching your kids about the markets too early!

"Who's awake?" is the rule by which you will govern your trading activities. Just because a trading time is convenient doesn't make it effective. One financial center is not necessarily equal to another in importance or

size. These are the financial centers that I keep on my desktop. I use a program called the World Tick Time Zone Clock. It's about \$20 last time I checked, and it allows me to put multiple, floating clocks on my desktop. You can go to [www.thirtydaysoftrading.com](http://www.thirtydaysoftrading.com) to download a free trial that is set to my specifications. You don't need this if you have another program that will do it for you, and it's certainly easier and cheaper than running out and buying six clocks.

When you sit down to trade, you must ask yourself which of the following six financial centers is open for the trading day. Let's first define what "trading day" is because it's how you will know when the active part of the work day is in each city you track. People are people. If you've done any amount of traveling, this becomes clear. No matter where you go we are all actually very similar in our habits and beliefs. The workday is no different. People in Tokyo more or less start work at 7 A.M. to 8 A.M. and wind down their day between 5 P.M. and 6 P.M. This is no different in New York, London, Frankfurt, Hong Kong, Singapore, or Sydney. And not too coincidentally, those are the main financial centers I keep track of.

So when you are sitting down at your computer, before you even begin analyzing any chart, you must know who is up and trading the markets. Which financial center or centers are active, which are going to be active, which are getting ready to call it a day? If the markets are open 24 hours, we know that there are shifts from one country to another as they begin their work day. This shift must be accounted for. In fact, one of my opening range strategies looks to capitalize on this *opening*. While the forex market does not close, humans in a sense do. We go home, eat, and sleep. Opening, lunch time, and closing time are worldwide, city-by-city realities we must acknowledge.

Let's break down each financial center and get an idea of who is moving the market and when.

## FINANCIAL CENTERS YOU NEED TO KNOW

---

Beginning with Sydney, as it is the first new look at the coming day, the forex market "opens" with the country of Australia, and so we focus on its importance as the initial opinion of the day. It's not the largest financial center by any means, but the first look of the day should not be ignored. Sunday afternoon New York time is the first look most traders have at the coming week, and brokerages in the United States open and allow traders to enter trades. Now I cannot account for the many brokerages around the world, but Sydney still represents the beginning of a brand new week no matter where you live. So starting with Sydney we move on to Tokyo.



Once Tokyo opens, you have a more significant Asian open, and this also creates the first market overlap. This means you have two major financial centers open and trading at the same time. Remember the only reason the forex market is a 24-hour market is that as one financial center closes you have another opening or preparing to open, and this accounts for the 24-hour liquidity. This concept of market overlap is a very important one because participation of multiple financial centers is what makes the trading during those hours more liquid and also more significant. The more people that are awake and trading during certain hours, the better it reflects a broader market psychology.

Once Tokyo opens or more accurately put, *becomes active*, one hour after Sydney, there is only Hong Kong and Singapore left to complete a full representation of the Asian session. Hong Kong and Singapore are in the same time zone, but both represent major financial centers, so I mention both. Realize that it takes just two hours for the Asian session to go into full swing once Sydney opens. But, alas, the Asian session currently only accounts for approximately 10 percent of daily turnover and thus does not even come close to being a major reflection of the trading day that is still to come.

I have to say that as I am on the east coast of the United States, I think in east coast time. I am however going to mention that most of the time you will see time represented in Greenwich Mean Time (GMT) when you look at most forex tools and sites. And that's fine just as long as you realize that GMT is basically London time and London trading hours are the most important in the forex universe. In fact, London is the 800 pound gorilla among the financial centers. GMT is also commonly referred to as UTC or Universal Coordinated Time. Regardless of what it is called, GMT gets its name from the solar time at the Royal Observatory in Greenwich, London. So don't worry when you see GMT, just think London. London is one hour behind Frankfurt and five hours ahead of New York.

London is the financial capital of the world to many. Sure Chicago is the center of the commodities world and certainly New York is the center of the equities world, but to forex traders, the European and U.K. session, represented by Frankfurt and London, are the most important. And yet I tell you that you don't have to get up and trade with these giants. Let me explain.

## PRIME TIME!

Prime time is the overlap between Frankfurt, London, and New York. It occurs between the hours of 7 A.M. EST (early) and 1 P.M. EST (late). That represents noon to 6 P.M. EST in London.

Now to give an idea of why these five hours are the meat and potatoes of the forex trading day I have to get into which pairs are by far the most actively traded. I'll preface this discussion by saying that this does not reflect the fact that I live in the United States. It reflects trading activity and trading activity alone. Not my trading activity, but the vast majority of traders around the world. According to the Bank of International Settlements, the most actively traded pairs are the EUR/USD ("fiber"), the USD/JPY ("dollar-yen") and the GBP/USD ("cable"). The next three pairs round out the top six most actively traded pairs: the USD/CHF ("swissy"), AUD/USD ("aussie"), and the USD/CAD ("loonie" or "canada").

By the way, as I mentioned earlier, traders shorten everything and give it a nickname. Apparently we can't help it. So to keep you from sounding like a complete "noob" (that's short for newbie or rank beginner) let me bring you in on trader-speak. Right off the bat, if you are referring to any pair that trades 1.xxxx, just drop the "1" when you are talking about it. So when you are telling someone about the EUR/USD trading at 1.2765, you'll just say "the fiber is trading at 2765." Got it? Now, of course, when you are placing a trade, say it properly. Full quotes only! Every pair seems to have a nickname and some have more than one. You'll hear the familiar "greenback" nickname for the U.S. dollar. The greenback nickname comes from when U.S. Demand Notes created by Abraham Lincoln to finance the Civil War were printed in black and green on the back side: greenback. The pound sterling—not the pair but the pound sterling itself—is referred to as "quid" named so from the Royal Mint in Quidhampton or the Latin "quid pro quo" meaning "what for what" as an exchange of goods for currency. Either way, "quid" it is. The "loonie" can mean the U.S. dollar/Canadian dollar pair or the Canadian dollar itself. It comes from the picture of a loon on the back side of a one dollar coin. The name "loonie" is so well known as reference of Canadian currency that the Royal Canadian Mint secured the rights to the name *loonie*. The "cable," which is the nickname for the GBP/USD comes from the Transatlantic Cable laid in mid-1800s that linked the United States and the United Kingdom by telegraph. Through this underwater cable, currency prices would be sent between New York and London. The nickname for the EUR/USD, "fiber" is a little more difficult to pinpoint. First of all, it's not that commonly used, but I personally think it is a good habit not to call the EUR/USD the "euro" as a nickname for the currency since there is actually a "euro" currency and this can be confused for the single currency versus reference to the pair. The "fiber" comes I think in part from "fiber optic cable" in much the same vein as the GBP/USD is called the cable, and also in part from the security thread that is woven into the center of a euro note, or perhaps and more likely is the fact that the paper for the euro banknote is 100 percent pure cotton fiber. There you have it, two good and one very obvious reason to refer to the EUR/USD as the *fiber*. You got your nickname background, now go use 'em!

So if you look back over the six most traded pairs, there should be one obvious common factor they all share. Know it? Yep, that's the U.S. dollar. They all traded against the U.S. dollar. So the focus on the prime time from 7 A.M. to 1 P.M. EST has nothing to do with when I want to trade or when it is convenient to trade but rather the all-important market overlap between Frankfurt, London, and New York. Once New York enters the picture you have U.S. participation in the markets, and that is where you will see the most impactful dollar trading events and opinion.

If you live in Europe or the United Kingdom, then there's certainly no reason you can't trade the major pairs and cross rates. I mean of course you can! You don't need me to tell you that. But keep in mind that U.S. economic releases and the U.S. Dollar Index futures will impact the pairs once New York gets active between 7 A.M. and 8 A.M. EST and of course be aware of 8:30 A.M. EST economic data releases as well as 10 A.M. EST as these are the two most common scheduled release times.

Cross-rates or pairs that don't trade against the dollar are certainly viable alternatives when the U.S. market is not open, but let me say that these are not always liquid pairs. "Liquid" is just another way of saying good volume. Good volume means there is plenty of trading in a market, which facilitates getting in and out with ease and a tight bid/ask pip spread. If I ask you, "What's the spread?" I am essentially asking you what the difference is between what price I can buy a pair for and what price I can sell a pair for. For the majors it is commonly three to five pips. As brokerages get more and more competitive, this spread is narrowing. The spread is your cost to enter. You pay the spread when you enter and exit. By the way, the spread is nothing new, nor is it solely a function of the forex market. There are spreads you pay in the stock and futures market as well. And just like the forex market, more liquid symbols have tighter spreads while illiquid symbols have wider spreads.

I often feel a little silly talking about illiquidity when it comes to forex pairs and cross rates. I mean after all, in a nearly \$3 trillion per day market (and still growing), it's difficult to find a pair that doesn't have decent volume. But I assure you, there are some that fall behind in the participation department. Look at the spread. If, as I mentioned before, the majors have a tight three to five pip spread, anything larger than that indicates one of two things: First the pair is, by comparison to other pairs, less traded, or second, there is an economic event or some such news event that is increasing volatility.

Cross rates should be traded when the home nations of the currency are active. To understand what moves a currency you must be in tune with events, political and financial, so that you can be ready for explosions in volatility and get an overall feel for what moves the pair and when it moves the most. That's the edge. It's not fundamentals I am talking about; rather

I am referring to the psychological ebb and flow of that financial center. I know I have this edge for the U.S. session as I live in the United States and trade the Dollar Index alongside my forex pairs. I know when the president, treasury secretary, Fed chairman, or other relevant official is scheduled to speak. I won't be blindsided by comments or events that I am neither awake for nor know about—as I could and would likely be if I traded the cross rates. Think about where you live and how you can attain this edge for yourself. Look at international calendars. I know, for example, that regardless of the fact that I live in the United States I must know the scheduled events for Europe and the United Kingdom, ECB (European Central Bank), Jean-Claude Trichet (ECB President), BOE (Bank of England), BOJ (Bank of Japan) . . . these are all factors that will affect the way the pairs trade. If you want a great international calendar, you can check out one of my favorites at [www.forexfactory.com](http://www.forexfactory.com). That calendar will give you the time, country, name, and expected impact of the data. Not to mention the all-important consensus number, which I will discuss later. The currency markets are interrelated in a way that most traders are unaccustomed to. Even some stock traders don't understand the degree to which their stocks are weighted in the large indices like the S&P, Dow, and NASDAQ. They fail to understand that when a leader of a particular sector is weak, that tide lowers all boats. Forex traders are in a similar situation but in a much broader, much more interwoven context.

I've often said and do believe that forex traders have a unique vantage point on the market. It's not only an asset but a necessity to be able to understand how the markets affect one another. Trading currencies encompasses all the other markets, equities and commodities included, because a currency is the stock of a country. Keeping this in mind, I don't want other markets to become a distraction or take you from the primary focus of the pair you are setting-up to trade, but there are relationships we will discuss later on; these are the market pulse charts.

It's important to consider the other markets that affect the pairs because the primary reason the overlap between Europe, the United Kingdom, and the United States is so valuable is that it combines a number of things that in combination make for the most active and volatile hours of each trading day. That's exactly why I consider this *prime time*. First remember that each financial center opens like a freight train. I purposely use 7 A.M. for each center because it's early and I know that as people filter into work there will be a gradual increase in market attention and therefore participation. Think of 7 A.M. to 8 A.M. in each center as the premarket and then 8 A.M. to 9 A.M. as the open. There is no bell, so it's not a horse race. As Frankfurt opens Europe, the opinions of the European financial community are reflected along with the last two hours of the Asian session. There is a two-hour overlap between Europe and Asia and a one-hour

overlap between the United Kingdom and Asia. But again remember, it's not as if Asia rings a bell and the currencies stop trading there. It slowly grinds to a halt as Europe slowly begins their open. Think of a baton being passed from one relay runner to the next.

The London session is my favorite to trade if and only if I am going to play a clearing session/opening range play. This is a set-up that can also be done specifically for the Tokyo open and the New York open as well but works best on London. It's fairly straightforward so I'll explain it here, since it is mostly a time-based strategy.

If you are coming from a stock daytrading background, this will sound awfully familiar; same goes if you have traded intraday futures. For those of you who haven't and for the sake of making sure that we're on the same page, let's explain the phenomenon of the opening range or "clearing period." Since most markets, other than the forex, actually open and close with a rather thin premarket and after-hours session, there are bulks of orders that are waiting to be executed before the real trading hours open. Let's use the U.S. stock market as an example. At 9:30 A.M. EST the market opens with the ringing of the bell on Wall Street. The flood of orders all waiting to be filled hits the order desks all at the same time. This rush of orders being filled, along with market makers and specialists taking their own position among the order flow creates a morning range that usually establishes a high and low 20 to 30 minutes after the open. That type of activity can and does translate to the forex market, but rather than the market open, we're looking at the financial center open.

These levels are known as the "clearing high" and the "clearing low" and reflect the upper and lower limits (think support and resistance) based upon the early mass of orders being filled. Again this all happens in about 20 to 30 minutes, so if you imagine London gearing up for the day, executing the orders first thing about 3 A.M. EST, which translates to 8 A.M. in London to 3:30 A.M. EST or 8:30 A.M. in London. These 30 minutes will hold the key to breakouts and breakdowns as the market action settles down and price action looks for the trend it will take for the day or at least for the morning.

In order to recognize the clearing high and low, use a five-minute chart. This is the only time I personally trade off a time frame this short in duration. The five-minute chart makes identifying the clearing highs and lows much easier. It's not that you are simply marking the high and low of the first 30 minutes of the day. Rather you are looking for a first morning reversal where you can see the buying shift to selling (the high) and the selling shift to buying (the low). Some days it's clearer than others. Some days it will basically be in the 30 minute high and low. I call these morning pivots, but let me be clear; these are not pivots points—just directional shifts that I call pivots.

Once you have the high and low drawn on your chart, sit back and wait. The play is to short breaks down through the clearing low support and

buy breaks up through the clearing high resistance. I will often use filters like the MACD Histogram that I use for momentum trading to confirm the breakouts/breakdowns.

While I call this an “opening range play” or set-up, I acknowledge that discussing an “open” is odd when it comes to a true 24-hour market . . . but there is an open and close as the major financial centers begin and end their trading day. That’s what we’re playing off. It’s a time-based strategy that reflects the psychology of the open and the support and resistance that are created by the mass filling of “overnight” orders and fresh orders for the morning. Consider the order flow reflective of banks and institutions and trading desks all across the financial centers and the countries it reflects, and you get a better idea of the kind of size that is executed upon starting a brand new work day.

Don’t make this set-up more complicated—it’s the simplicity that makes it work and frankly the shortened time frame doesn’t entertain getting too analytical about the price action! The point here is to realize that this is (1) a short term time frame set-up—tried and true “daytrading” and (2) the breakout or breakdown is not meant to be taken as a new trend but rather a momentum play. If you’re up early one morning, give this set-up a try. At least draw the clearing levels and see how the price action plays out a few times before trying it with your live account.

Prime time is the four to six hours where the focus is primarily on London and New York. Here’s the thing about prime time, though. Once London winds down its own trading day, it essentially ends the market overlap between two financial centers. Realize that once London is closed the only major financial center open is New York. No overlap, no trading.

The fact that the majors all have one thing in common (the U.S. dollar) and the fact that the bulk of U.S. data which would affect the greenback is released typically between 8:30 and 10 A.M. EST, accounts for the importance of the hours between 7 A.M. and 1 P.M. EST and also for why it is the most volatile time for the EUR/USD, USD/JPY, GBP/USD, USD/CHF, and USD/CAD. Next, we’ll take a look at the actual pip movement ranges over time. While I am sure most of you will take my word for it when I say focus on the European, U.K., U.S. overlap, a few statistics to back it up won’t hurt.

## **PIP MOVEMENT**

The graphs that I am about to show you are courtesy of Autochartist PowerStats. ([www.autochartist.com/autochartist/PowerStatsBasic](http://www.autochartist.com/autochartist/PowerStatsBasic)) They are pretty self-explanatory, but there are few ideas I want you to consider as you look at each graph.



First, take note of more than just the highs and lows of each trading hour—which are all in EST—notice the average.

Second, don't think that just because the pair has a higher high range that it is the pair you should be trading. (Note to you GBP/JPY traders! Traders don't call that pair the "twisted sister" for nothing!)

Third, notice how often the 8 A.M. to 10 A.M. period is the most active and most volatile. That's a double-edged sword, my friends!

Fourth, notice how inactive the Asian session is for most of the major pairs ... but not all the pairs!

Fifth, well, there's really no fifth; however, what I want you to come away with from these graphs is to hammer in the prime time of each pair into your habitual trading and notice when the activity drops off and picks up again in line with regular economic data releases.

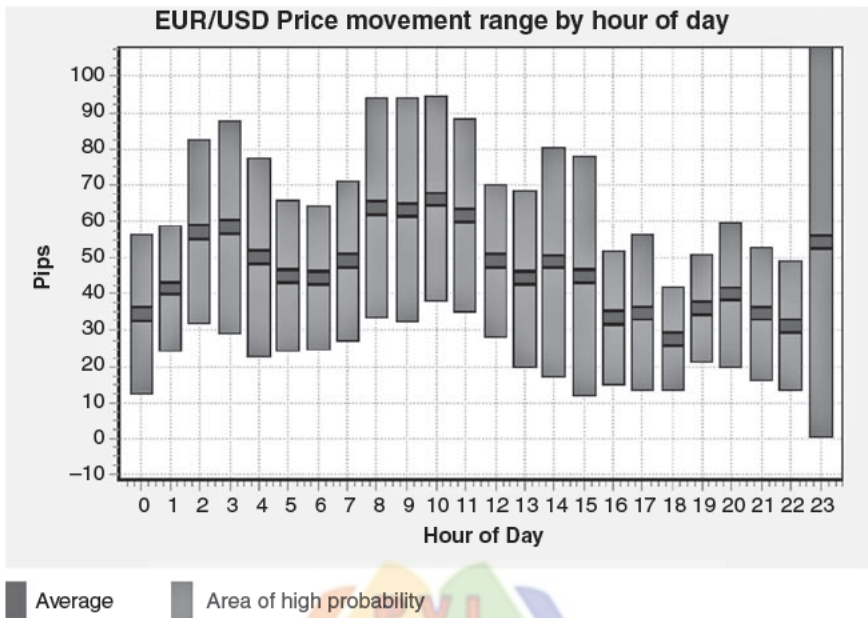
The graphs are set to a six-month sample, which means that while this is typically representative of the average pip movement, unusual occurrences can and will affect the overall range and thus the average. These do not usually skew the data to the point of taking you away from the main active hours, but can make certain hours look more active than they would historically be. In the following graphs, the 23:00 time was affected by such a one-time volatile occurrence in the last one month. I will keep updated graphs posted at my personal blog [ragheehorner.com](http://ragheehorner.com) every few months so you can certainly check on any changes or observations I am making note of.

PAKISTAN VIRTUAL LIBRARY  
[www.pdfbooksfree.pk](http://www.pdfbooksfree.pk)

## A DAY WITH THE EUR/USD

The graph of the "price movement range by hour of day" of the fiber (you know that's the EUR/USD now, right?) is laid out in a 24-hour breakdown, and it is in Eastern Standard Time. Now recall when each financial center is coming in and out of the market as you look at each hour on the graph. Remember that the fiber is representative of Europe and the United States. (See Figure 7.1).

The specific hours to focus in on are the 17:00, which would be Sydney's first look at the day; then 18:00, when Tokyo is gearing up for their trading day, and then jump ahead to 2:00, when Frankfurt enters the picture and creates the European/Asian market overlap. Notice the bars, the high, the low, and the average. Again, keep in mind that the 23:00 is an anomaly representative of a move that is not a historical norm. What can we get from this chart—the most traded forex pair—as we look at the nature of its hour by hour trading? When is this pair the least active? You can clearly see that the hours between 16:00 and 22:00 are the least volatile. If you were to ignore the 23:00 anomaly you would see that activity does not pick up again until 2 A.M. EST which is 8 A.M. in Frankfurt. So how active is



**FIGURE 7.1** A 24-Hour Look at Pip Movement in the EUR/USD

this pair in the Asian session? Not very. How about looking at the 8:00, 9:00, and 10:00 hours? These are prime time hours when New York is overlapped with Frankfurt and London. They are also the hours that most often include the key economic releases in the United States and thereby affect the U.S. dollar. That's the importance and the reason why the hours between 7 A.M. EST and 1 P.M. EST are so important. You could really narrow it down to between 8 A.M. and noon EST, but there are set-ups and price action that merit being at your desk a little earlier and staying a little later.

Now if you weren't sure if Europe and the United Kingdom require or wait on the opinion of the United States to move the EUR/USD, take a look at the lull at 5:00, 6:00, and 7:00. After the Asian/European overlap ends at 4 A.M. EST and the last push of order comes out of Sydney, Tokyo, Hong Kong, and Singapore, you'll see that while Frankfurt and London make up the largest percentage of activity for the forex market each day, somewhere typically in the vicinity of 40 percent, they seem to be waiting for New York to join the party. So what does that tell you? Unless you are willing to sit through what can be described as a slight trough in activity between Asia winding down and the United States gearing up, you are likely just as well to wait to trade until 7 A.M. EST. And that's why I don't get up at 2 A.M. EST!

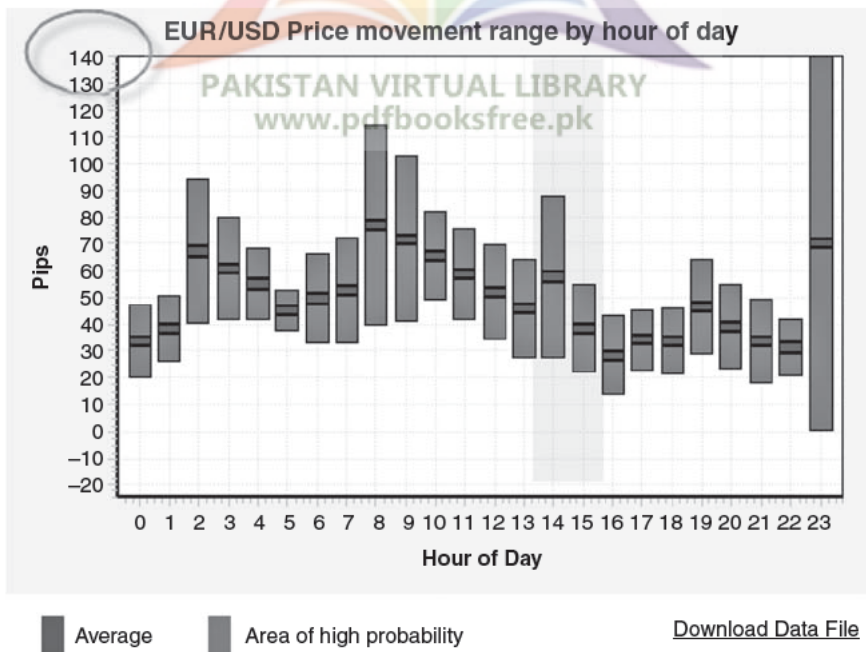
Now let me add this: There are days when set-ups will trigger during these hours between 2:00 and 4:00. Certainly I am not saying that the

opinion of Europe and the United Kingdom don't matter! What I am saying is that it is incomplete and the follow through for trades will often come during prime time.

Let's also define the listless hours by these PowerStat pip movement range numbers. Do you notice the decrease in volatility starting after 10:00? This is because the economic reports have been released, and most of the data (if there indeed is any that day) has been reacted to. As London approaches 5 P.M. and it nears 12:00 EST, you'll see New York's afternoon doldrums begin.

The spikes at 2:00 and 3:00 show the effect of 14:15 (2:15 P.M. EST) FOMC rate decision and statements. Remember this is a six-month look back at pip movement, and there will be a couple FOMC events factored in.

Look at when I take the events out of the look-back and go down to a one-month look at 2:00 and 3:00. Even more important, take a look at how much more volatile the past one month has been when compared to the last six. Be sure to look at the price (vertical) axis to see the difference. This one-month chart has an upper reach of 140 pips versus the six-month at just over 100 (see Figure 7.2).



**FIGURE 7.2** EUR/USD Price Movement Range by Hour of Day: One-Month Chart Images © Autochartist.

Note the high of the 23:00 EST, which occurred during the Asian session.

Another important fact about understanding pip movement range is that the personality of a pair can change month to month. You will probably notice this by simple observation and through your daily chart analysis, but having the statistics to help identify upper and lower reaches of price action can be extremely helpful when managing the risk and reward of taking a trade.

This is just one pair and two look-backs, the six-month and the one-month, and you can see how quickly a few distinctions about this pair and its past and current trading habits can be made. Imagine the impact on your day-to-day analysis and risk management. How can you use this data to set better expectations of where you think a trade can follow through to and what type of volatility you can expect depending upon when the trade triggers? A trade triggering at 5:00 will behave very differently from a trade triggered at 10:00!

## **TIME OUT!**

Before I go much further and we delve deep into this, I want to mention now that this is not just some number crunching and time observations and mental exercise, although that could be interesting enough I suppose. The reason Forex in Five traders need to know more about time and how that relates to participation and how different participation affects volatility is because picking your trading time depends upon all these factors!

By the way, as we dissect the pairs, recall the opening range play I walked you through earlier where you capitalize on the high and low of London's open between 3:00 and 3:30 A.M. EST or 8:00 and 8:30 A.M. London time? Well, let's examine that for a moment with the EUR/USD pip movement range information of the 3:00 bar. There are times when the 2:00 will be the more volatile of the two, and when you see this shift occurring, you can actually apply the same strategy to the Frankfurt open—but again only when the pip movement range confirms that Frankfurt is opening with a wider range than London. The one-month look-back on the pip movement range will indicate when you can make that shift. The other observation pertaining specifically to the five-minute chart-based opening range play is that after 4:00 if the market has not already made a move through the upper to lower end of the opening range, it's likely to move with less volatility until almost 8:00.

The impact of each financial center should be observed not only when they enter the trading day but also when they exit. Take a look at the hours



of 4:00, when Asia exits the market, and 12:00, when London exits the market. These are also important and potentially volatile times, and, more important, they occur during market overlaps!

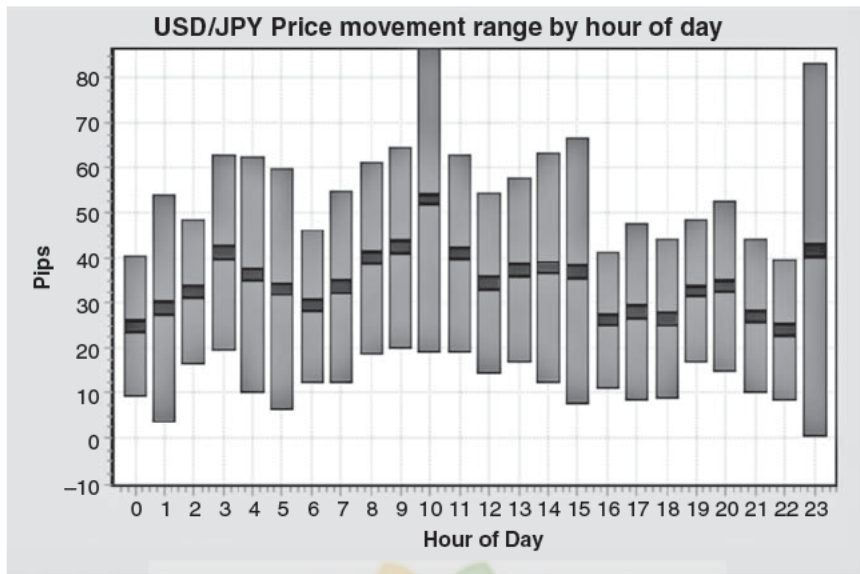
Let's continue examining each pair because while the ideas we carry about on how to use this data can effectively extend to the other pairs, the characteristics of each pair are unique to it and the financial center it represents.

Let's jump to the USD/JPY ("dollar-yen") and look at how this pair behaves. Asia is the third-largest participant in the forex. Asia at a typical 9 percent to 10 percent of daily turnover comes a distant second to the United States, which is normally somewhere between 18 percent and 20 percent. As mentioned before, Europe and the U.K. come in at about 40 percent on any given day. Of course, remember that national and bank holidays will affect this participation, so one of your daily habits must be to look at whether one of the financial centers is on holiday. In fact, it's best to do this at the beginning of each week. I will glance at the entire week's economic calendar on Sunday night so I can prepare for the likely volatility based on holidays and major reports before I start my trading for the week.

The dollar-yen is currently a proxy for Japan, China, and Singapore—essentially all of Asia. Now this is regardless, truly, of whether this proxy idea is correct or not. Bottom line, that's how it is viewed. While Asia as a whole (and this includes Australia and New Zealand) might rank in third place in the forex participation standings, it does reflect the first look at the new day and China. China's yuan is not heavily traded as a forex pair. Not now and with its peg to the dollar there's no reason to think it will be any time soon. To say that any country manipulates its currency is a little childish. Of course, all countries manipulate their currency for their own benefit. Manipulate may sound sinister, but I can assure you that what central banks do in each country in the name of regulation can be construed as "manipulation" by another country. Don't fall into that political trap. Trading pays homage only to price action. There will be times when news out of China will affect Asia, and you will see the USD/JPY move as a result. It's the outlet. Be aware of this.

Trends coming out of Asia are also going to be affected by the Frankfurt and London opening so don't ignore this because at 2 A.M. EST is when two worlds will collide. Because of its size, the Europe and U.K. market will simply either agree with the sentiment coming out of Asia or move the market around according to its own sentiment. Either way it means that 2 A.M. EST, 8 A.M. in Frankfurt is a potential reversal time for the Asian market as it winds down to its final few hours (see Figure 7.3).

Since the USD/JPY is reflective of Asia and the United States, there is a tremendous time span of trading opinion that this pair has over most others. You could consider the AUD/USD (the "aussie") and the NZD/USD



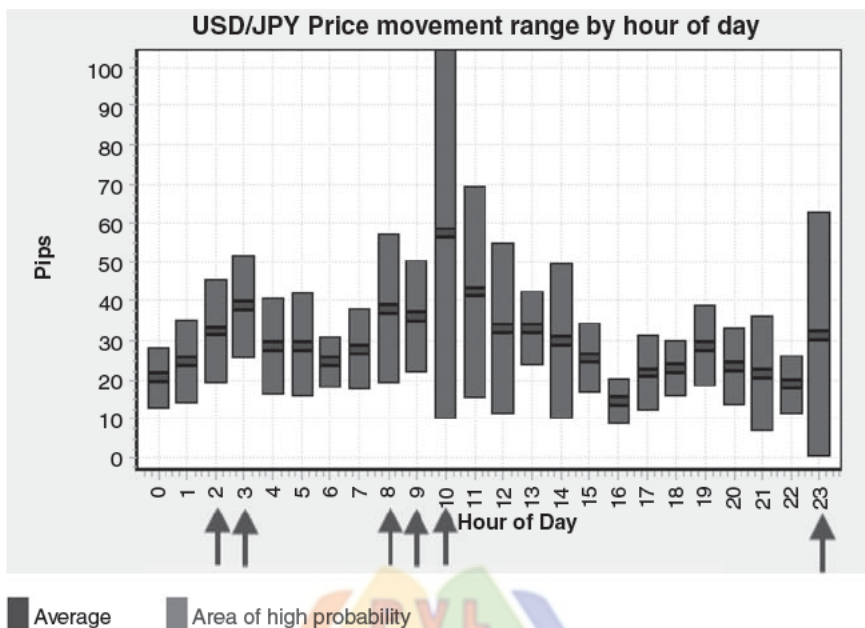
■ Average      ■ Area of high probability

**FIGURE 7.3** A 24-Hour Look at Pip Movement in the USD/JPY  
Images © Autochartist.

(the “kiwi”) to have a similar trait, but these two pairs are nowhere near as heavily traded as the dollar-yen. The dollar-yen will pick up activity as Tokyo gears up but notice that the real activity does not begin to accelerate until 1:00. The 23:00 bar again represents a volatile event from the past month. In this case, pertaining to the USD/JPY, is likely an 11 P.M. EST BOJ (Bank of Japan) Governor or member speaking or an Overnight Call Rate and Monetary Policy Statement as these mainly occur between 23:00 and 24:00. So this 23:00 spike is reflective of an economic event or what I call a “hot zone.” 11 P.M. EST to midnight is a common hot zone for the dollar-yen. Just as Federal Reserve Chairman Bernard S. Bernanke can move the markets with speeches and remarks, remember each financial center has their own version of Bernanke. Keep an eye on your economic calendar for these events. If it is a scheduled speech or event, it will be listed at [www.forexfactory.com/calendar.php](http://www.forexfactory.com/calendar.php). Remember that the PowerStats program updates daily and samples from one, three, and six months can be viewed. I will also share these regularly at my blog.

Even with an event like the 23:00 in the USD/JPY, notice that volatility quiets down in the following hours until London gets active. Even



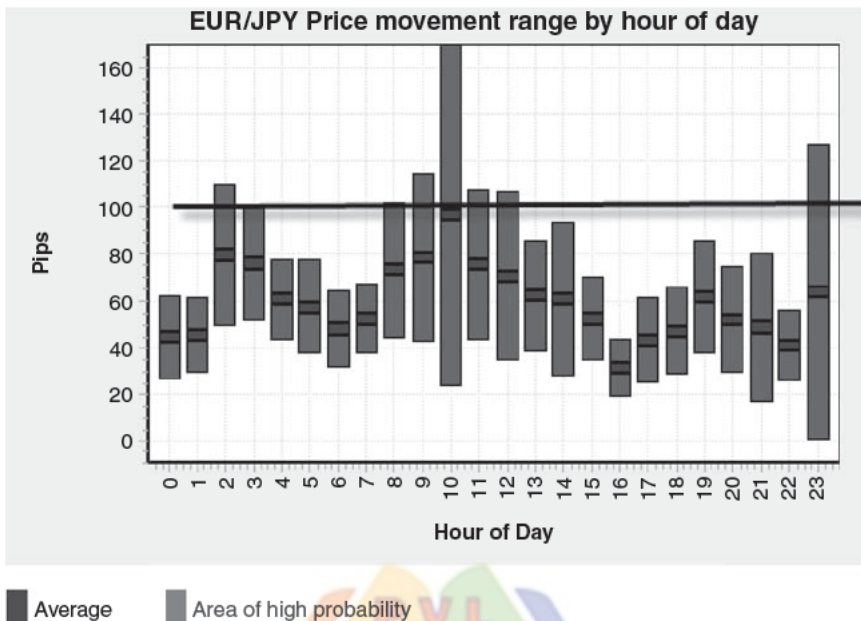


**FIGURE 7.4** Traders Must Know the Most Volatile Hours of the Day  
 Images © Autochartist.

Frankfurt's open doesn't inject much volatility into the USD/JPY. Although it is greater than the hours that preceded the European open, other than economic events, notice that the Asian session doesn't move the USD/JPY that much. Here's a one-month look back. Notice the activity increase at 2:00, 3:00 and 8:00, 9:00, and 10:00 . . . not to mention the drop off from 10:00 to 11:00 as London winds down for the day (see Figure 7.4).

**The fallacy of trading even what could be considered the most traded pair that connects Asia to the United States is not that active during the Asian session.** When, if ever, do you want to trade the Asian session? Here's a tip, focus on sessions that are expecting economic releases, refer to your calendar, and let that be your guide. Hear me out, though! I am not talking about trading the news but rather the fact that Asia only moves dramatically on news days. That is both a risk and reward consideration.

Now let's stay with a pair that is influenced by Asia, the largest cross-rate, the EUR/JPY or euro-yen. Here we have a pair that trades against the U.S. dollar and will most certainly be affected by Europe as it pits the Japanese yen versus the euro. This pair will be affected by economic events from both Asia and Europe and thus, will have two countries that can move



**FIGURE 7.5** How Often Does the EUR/JPY Move More than 100 Pips an Hour? Images © Autochartist.

it dramatically. It will be viable and active throughout two financial centers and have a two-hour market overlap. But to truly see when the activity takes place, we have to look at the pip movement before making any assumptions (see Figure 7.5).

This is a one-month look-back at the EUR/JPY, and as you can see the most volatile trading occurred at 10 A.M. EST, in the heart of, not the Asian/European overlap, but rather the Europe/U.K. and U.S. overlap. However, don't take my pointing out the most volatile times to mean that these are the only times to trade. It's simply that this is when the most participation occurs with the most pip movement. Alternatively, trades taken during, for example, from 1:00 to 7:00, would still be active but simply with less pip movement, which as I mentioned is both a risk and reward consideration.

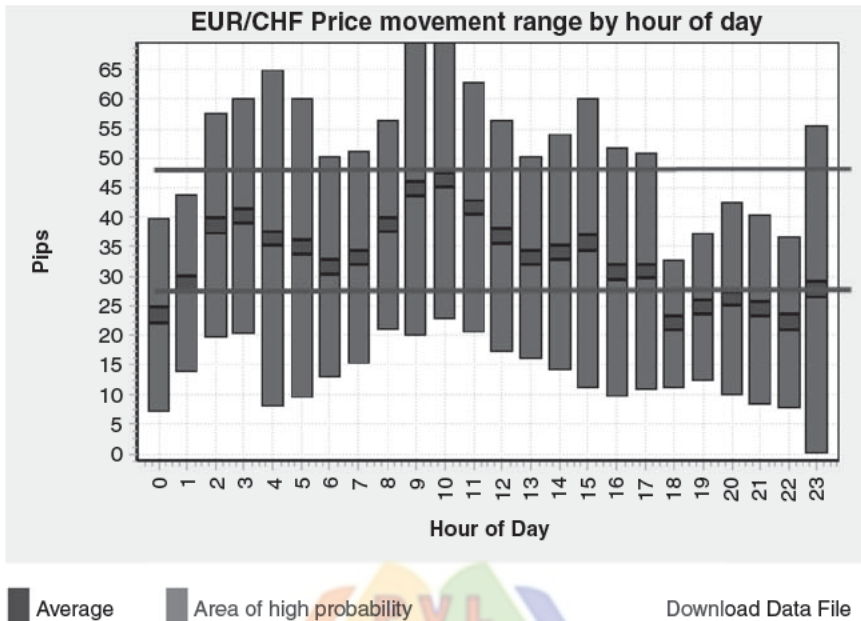
Of course our old friend 23:00 is active as the Japanese economic events affect the volatility of the pair. By and large, though, this pairs range high exceeds 100 on just a handful of bars on the chart, meaning that during these one-hour chunks in time, the movement can be 100 pips and sometimes more. So once again, even on a pair that seemingly would require little U.S. opinion, the most active trading times are occurring right in the

middle of the London/New York overlap. Focus not just on the range high but the average, which is the dark band that represents the averages within the overall high to low range.

Again, as we go through each one of these graphs, I don't want you to necessarily eliminate a trading time from your potential trading schedule, but instead get a feel for when each pair does and does not move. Accordingly, you can go about defining the most likely risk and reward scenarios of the pairs and apply these to the time your trade triggers.

We can, of course, plop down in front of our computer whenever we want, that is a personal choice, but in order to maximize the time spent in front of the charts and make Forex in Five a reality we must know when the pairs will move and we are likely to see follow-through. Timing is often the folly of traders who attend a seminar and decide that a 24-hour market means that there is always a trade occurring that is ripe for the picking. While that may not entirely be untrue, good trades don't come along every minute of every day, and good traders know this. In the United States the most common problem is the after-work trader. This puts most U.S.-based traders in front of their PC in the beginning or middle of the Asian session. Trades are placed in comparatively the thinnest session and then put to the mercy of the 800-pound gorilla that awakes in Frankfurt and London. What's the lesson here? I am not saying you can't trade Asia, but if you are going to trade these hours when Sydney, Tokyo, Hong Kong, and Singapore are active, place and exit your trades before 3 A.M. Unless you are going to be up for the London open, you should likely be flat or well within the positive side of your trade so you're risking only profits and not capital. Longer-term charts such as the 80, 240, and daily can be traded into the European and U.K. session. This is because it is most likely that the market cycle that developed to set-up the trade that was taken has, because of the longer time frame, been influenced to a great degree by the U.S. and the European/U.K. session, and is not simply an Asian session trade. Make sense? That is one of the advantages of longer-term charts and why the longer the time frame the more it represents the world view of a pair and not just a handful of financial centers. This is precisely why I say the daily chart is the most psychologically significant time frame: The range reflects every financial center around the world in 24-hours.

What about a cross-rate pair that is based solely out of Europe like the EUR/CHF? First, I want you to see that as pip movement ranges go, this is one of the lower ranging but consistent movers throughout the day. I want to offer here a word of caution regarding the cost per trade when it comes to cross-rates. We pay the spread, that's your cost per trade. You pay the spread going in and going out because we buy at the seller's price (also known as the "ask") and sell at the buyer's price (the "bid"). Not all pairs



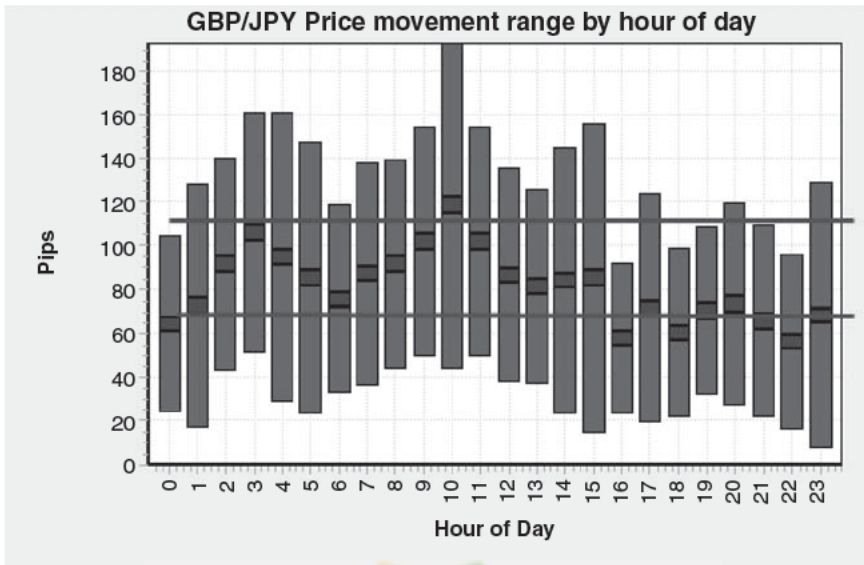
Average
  Area of high probability
 [Download Data File](#)

**FIGURE 7.6** The Average Pip Range in the EUR/CHF Is between 30 to 50 Pips an Hour  
 Images © Autochartist.

trade with the same bid/ask spread, and the spread can change throughout the day depending upon a number participation-based and volatility standards as set by your broker. Economic events equal potentially high volatility and higher spreads. Low participation can also increase the spread. Know your cost per trade (see Figure 7.6).

The EUR/CHF (“euro-swissy”) is a European pair, in that each of the currencies that make up the pair are European countries. Because the EUR/CHF has the euro in the pair it has a worldwide appeal as many of the pairs that trade against the euro do not seem to be affected by a lack of “home country” participation. From 0:00 to 23:00 you can see that the EUR/CHF trades with a typical average of between 30 or just over 45 pips per hour. Notice that again, the highest high of the pip range still occurs with the London/New York overlap. Compare this relatively sedate pair with what is nicknamed the *twister sister*, the GBP/JPY.

Famous for eating newbie accounts with a single bite, the “pound-yen” does indeed pound many trades into tears. The siren call is the high pip range, the possibility for the killer trade that can yield upwards of 100 pips in a very short amount of time (see Figure 7.7).



Average
  Area of high probability

**FIGURE 7.7** The Average Pip Range in the GBP/JPY Is between 70 to 115 Pips an Hour  
 Images © Autochartist.

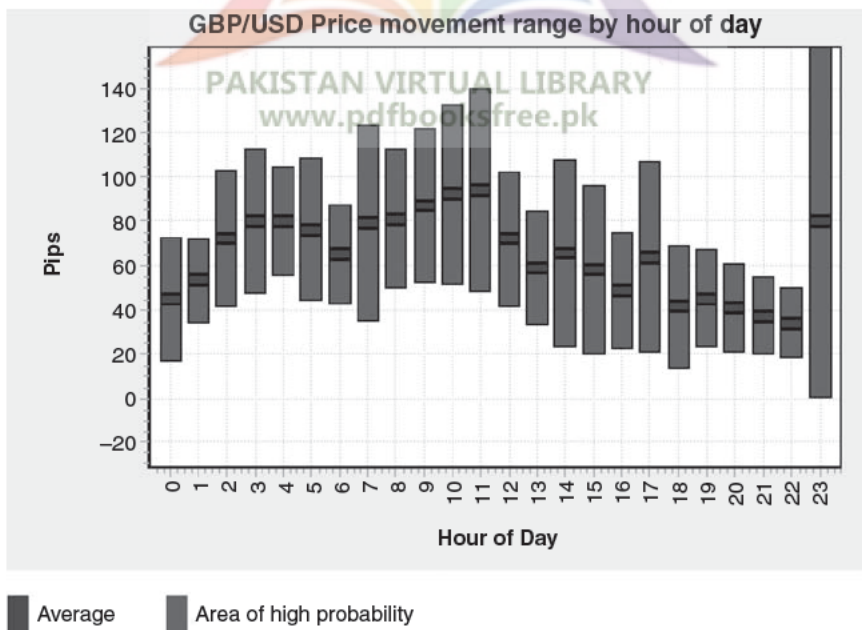
With an average per hour pip range of 70 to 115 pips, this is the high-speed pair that is an account killer. Can you tame it with the help of some timing and average pip movement analysis? Let's take a look. We can dissect its habits as we look at its behavior in the Asian session and then during the overlap and then finally as the European and U.K. markets take over. This type of time analysis can be done on any pair and should be done on every pair you choose to trade. If we can take this bad boy of a pair apart, we can do it with any pair.

First, let's start with the Asian session, as that is the first group of financial centers that will trade the pound-yen. On the graph we will focus in on 18:00 as that is 6 P.M. EST and 8 A.M. in Tokyo, 9 A.M. in Sydney. This is a solid market overlap between those two cities. As you can tell, it's rather quiet during these hours and if the market cycle is in a momentum cycle, look to identify the ceilings and floors that could trigger a breakout or breakdown once action livens up. So when will action liven up? Look to Frankfurt and 2:00. Now the way you can best identify the expected volatility is not the high or low of the range but rather the average. Notice that the average heads lower each hour from 10:00 to 12:00 and stays steady



from 12:00 to 15:00 before dropping off once again from 16:00 to 1:00 before increasing with Frankfurt's open. From 2:00 to 3:00 there is a burst that drops off with the end of the European/Asian overlap until again the GBP/JPY ramps up going into the New York open where it really begins to accelerate in volatility. Whether you look at a one-month, three-month, or six-month look-back, the pip movement is greatest at 10:00.

What does all this tell us about how and when to trade this pair? First we must expect that this pair will average over 70 pips per hour almost every hour of the day. The quiet hours are actually at the end of the New York session and in the early Asian session. Now, how can we use this to manage any entry or exit? First, in terms of wiggle or how much the pair can move around from hour to hour, that number is going to be high. At a 70 pip average it is not for the short funded or faint of heart. Compared to the USD/JPY, which averages between 25 and just over 50 pips per hour throughout the day, it's a high wire act. But when you look at the cable (GBP/USD), which averages between 40 on the low end and 100 pips on the high end—again these are the averages not the total area of probability—you can see that the GBP/JPY takes after the cable more so than the dollar-yen (see Figure 7.8).



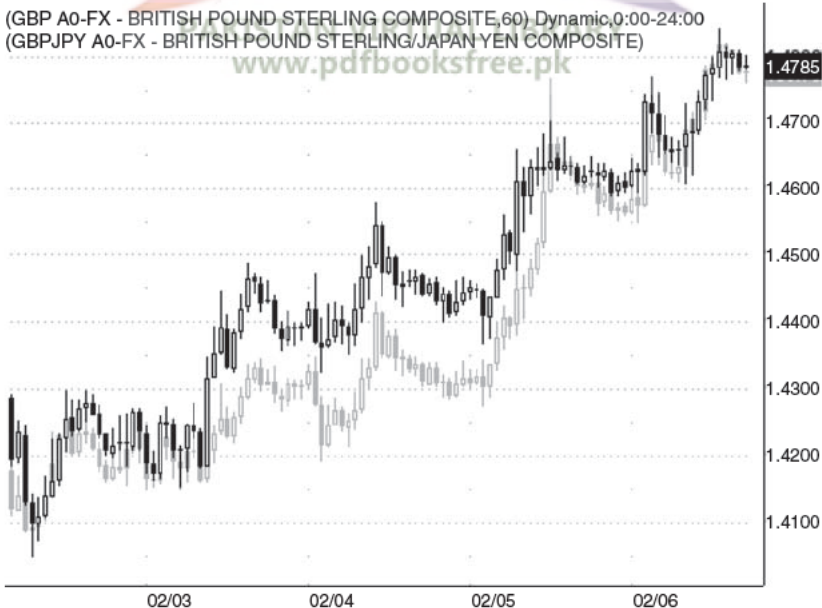
**FIGURE 7.8** Average Pip Movement Range in the GBP/USD  
Images © Autochartist.



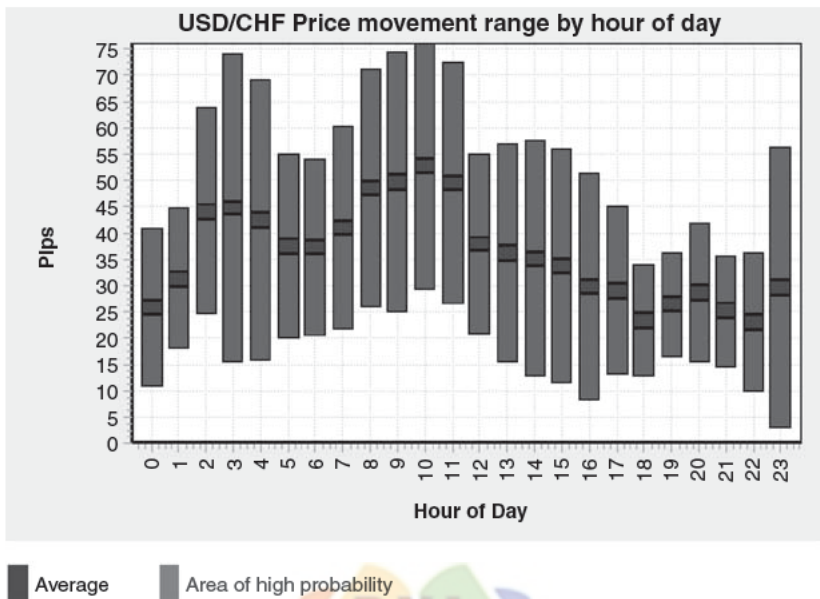
What does this chart tell you about the volatility of the pair called the “twisted sister”? The GBP/USD consistently trades in a range of 40 pips or more an hour.

In fact, directionally speaking, if you were overlaying the chart of the GBP/USD over the GBP/JPY you would see that they move in tandem. This is another layer of analysis that gives you insight into correlation and the “one mind, many markets” philosophy I embrace to help me manage multiple positions in the market. When you know that one pair is going to more or less move with another, there are ways to manage both with ease, and that is to understand intermarket correlations and also correlations to specific futures contracts. While this may initially seem like more work, like anything, once you get the hang of it and work it into your daily routine, the time it takes to keep an eye on key levels and market cycles of multiple charts becomes much easier. You get a feel for them the more you watch them and understand the pip movement ranges (see Figure 7.9).

Most traders do not have a problem trading GBP/JPY because it is an awkward trading pair. It's not. The problem lies in a lack of getting to know what it is capable of and what it moves with. Placing stops too closely that do not account for the wiggle or pip movement range that is particular to this pair is a problem. You should make that adjustment for any pair



**FIGURE 7.9** The Correlation of the GBP/USD and the GBP/JPY  
© eSignal, 2009.



**FIGURE 7.10** The USD/CHF Averages 45 to 55 Pips during Prime Time Images © Autochartist.

you trade! That's the error in judgment, and it's actually more an error of incomplete, not necessarily incorrect, analysis.

Let's take a look at another pair, this time the USD/CHF or the swissy. This pair will reflect the European session and once New York becomes active, you must factor the added participation into the expected volatility. The swissy is an example of a pair that can yield almost the same high volatility during the Frankfurt and London open as it can during the New York 8:00 to 10:00 piece of prime time. The drop-off once the Asian session overlap is gone is significant in that the high of the range is lower but the average remains within 5 to 10 pips of the 2:00 and 3:00 trading hours. The significant doldrums for this pair can be seen throughout the early and mid Asian session as it is only when Frankfurt and Asia overlap that the average picks back up above the 40 pip per hour level. The swissy is a pair that trades consistently at a 40 pip hourly average from 2:00 to 11:00, dropping off only as London closes for the day (see Figure 7.10).

## CHOOSING YOUR TRADING TIME

If there's one thing that becomes abundantly clear as you look at the pip movement ranges across not only the majors but also the cross-rate and

comm-dolls, it's this: the hours between 8:00 and 10:00 are consistently the most active. That makes the overlap between Frankfurt, London, and New York prime time. That also means that much of your follow-through for trades will occur during these hours, but that doesn't necessarily mean the bulk of your entries will. For 15-, 30-, and 60-minute charts, these hours are the best to trade. But if you are trading longer-term intraday time frames like the 180 and 240 or the end-of-day time frame, these two hours will be a blip on the overall radar since the sheer size of a three- or four-hour chart and most especially a daily chart will swallow up the volatility of a mere two hours of trading.

The pros of the Asian session are that new traders are not likely to take big hits when they are wrong if they understand that the Asian session is not as volatile as the European, U.K. or U.S. session and adjust their risk and rewards expectations accordingly. The problem is not the session but the expectations of follow-through that the session typically provides. With the Asian session, there is the added knowledge that each day as Europe enters the market it begins what could be a significant reversal. It's best then for a trader to leave protective orders in the market that will account for this if there is an open trade going into 2 A.M. EST. I'll be talking at length about Stop Loss Placement in Chapter 12.



## CHAPTER 8

# Market Pulse



**Always respect the market, but don't fear it!**

2006 "Fxstreet.com. The Forex Market." All Rights Reserved.

The forex market pulse is something that came from my background as a long-time futures trader. Long before trading pairs, I was trading currencies in the futures market. I was also trading other pairs like the Dow minis, gold, crude oil, and the U.S. Dollar Index among many others. I was already familiar with their trading behavior, so it didn't take long to discover that there were correlations that affected the forex pairs. I already knew that markets like gold and crude had an effect on the dollar, and since the dollar was half of each of the major pairs and commodity

currencies, I felt that by bringing over my existing futures knowledge I had an edge. That's what I will share with you now.

I want to caution you that if you do want to use these charts you will need a futures feed. I will offer some alternatives to real-time feeds that can be costly. My favorite is [www.quote.com](http://www.quote.com) mainly because the same symbols you see me use on the charts in this section can be typed in letter-for-letter in Quote.com, and you can get produce overlays there too. I also want to remind you that these are secondary correlation charts. What I mean by that is that the primary chart should always be a chart of the market you are actually setting-up to trade, which means that these market pulse charts are not the primary reason you should be buying or selling anything. They are effective as confirmation, and while they should be tracked daily, they should not supplant the market cycles and chart set-ups on the pairs themselves. Far too often after learning about the market pulse, I will see traders short the EUR/USD simply because they feel the U.S. dollar is going up, for example. This is incorrect not because their thinking is wrong but because the only reason you should be short anything is because your analysis is pointing to a bearish direction for price. Got it?

What I will share in the following charts are the relationships to be on the lookout for. Now you can choose to do these daily on your own, or you can refer to the chart I post at my personal blog [ragheehorner.com](http://ragheehorner.com) for insight into the overall direction of the market pulse. I do this weekly at the site, and this alone can begin to give you insight and the edge that only the market pulse can provide. Each pair has a correlating chart, sometimes two, but there is typically a primary correlation, and that's the one you want to keep an eye on.

The U.S Dollar Index is the main market pulse chart. It is a futures contract that measures the performance of the greenback against a basket of other currencies, and this contract is traded on the New York Board of Trade.

You can find out more about this index at [http://ragheehorner.com/blog/?page\\_id=468](http://ragheehorner.com/blog/?page_id=468). This is the market that affects the most currencies and the one that is affected by the other market pulse charts. When you look at the dollar, you must consider the effects of higher or lower crude oil, gold, commodities index, the Dow, and Fed Funds as these all impact the direction of the dollar and therefore are supporting cast in the overall scheme of things. That does not mean that the crude, gold, commodities index, and Dow are not worthy of primary correlations, but with specific pairs. The U.S. dollar, since it is half of each of the most traded pairs in forex, has a correlation to most of the pairs you will trade on a regular basis.

The most direct correlation between two charts has to be the relationship between the U.S. dollar and the EUR/USD. This is almost a move-to-move relationship that all traders who are setting-up a trade on the fiber



**FIGURE 8.1** Directional Correlations between the USD/JPY and U.S. Dollar Index  
© eSignal, 2009.

PAKISTAN VIRTUAL LIBRARY  
[www.pdfbooksfree.pk](http://www.pdfbooksfree.pk)

should consider. Notice that it's an inverse correlation, though! Support or resistance in the U.S. Dollar Index does translate into levels that can blindsides a forex trader if she does not know they are there. The correlation is inverse, which means that when the U.S. dollar is in an uptrend the EUR/USD is heading lower as shown in Figure 8.1.

Think about what the quote means in this pair. The current price the EUR/USD was trading at when this screenshot was taken was 1.2851. This means something very tangible. It means that each euro is worth \$1.2851 in dollars. Or think of it as if we jumped on a plane to Paris and wanted euros. For each one, we need 1.28 in dollars. If we were returning to the United States with a pocketful of euros, we would get 1.28 in dollars for them.

As the dollar gains in strength, it has more buying power, and this yields more euros on exchange. Remember "forex" is the foreign exchange! The increase in trading volume in this market is not just speculative; it's caused by the increase in international business and trade. And despite any protectionist talk out of Washington, this exchange of one currency for another, as companies do business abroad, is not going anywhere.



## U.S. Dollar Index and USD/JPY

(DX A0 - US DOLLAR INDEX FUTURES,D) Dynamic,0:00-24:00

(JPD A0-FX - JAPAN YEN COMPOSITE)

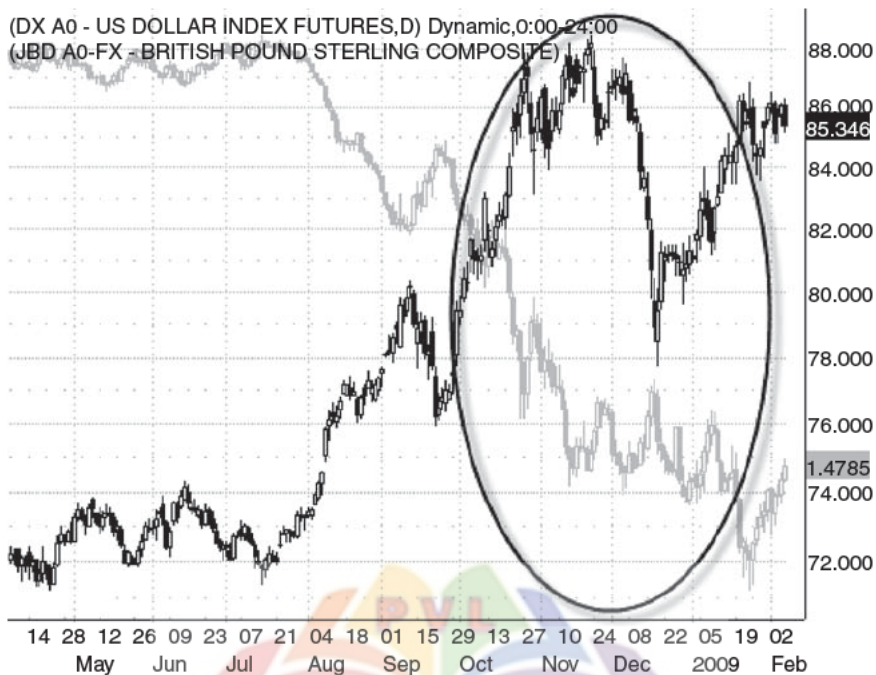


**FIGURE 8.2** As the Dollar Strengthens, the Yen Weakens Against It and Heads Lower

© eSignal, 2009.

When the EUR/USD moves, the direction can be gauged from two countries. Bullish news and events out of Europe move this pair higher on the charts as the euro gains over the dollar, while bullish news from the United States pushes this chart lower. Now there will be times where there is neither bullish news or bearish news coming from other countries, and the pair will move regardless because in the end it's the comparison of current and future expectations for each currency that allows one currency to gain strength against the other.

The U.S. dollar and USD/JPY pair does not have a consistent relationship. Later when we look at the Dow and USD/JPY, you'll see an example of a better more reliable correlation. In Figure 8.2 you will see that from July to December/January the direction was sympathetic as the two markets moved together. Unlike the dollar and fiber, which has a strong but inverse correlation, the dollar and dollar-yen can be at times sympathetic or inverse. This makes this relationship unreliable and one that, while it cannot be ignored, needs to be watched closely for the current relationship to be identified. Notice that it does change and hold the relationship



**FIGURE 8.3** Correlations Are Not Fixed and Can Change under Different Circumstances!

© eSignal, 2009.

for some time when it shifts. In the span of time represented on the chart, each shift held for about four to six months.

The chart of the dollar-yen trends higher when the dollar advances against the yen and also when the Dow strengthens as well. We'll look at the relationship with the Dow later. The quote tells us how many yen each U.S. dollar will get. Currently that's 85.346 yen per dollar as shown in Figure 8.3.

The U.S. dollar Index and the cable have an inverse relationship akin to the cable's *cousin*, the fiber. I often will refer to the GBP/USD as a drama queen because it will not only move inverse to the dollar's action but will do so in a more emphasized manner. Correlations must be measured by direction (sympathetic or inverse) and scale. Some pairs will simply move more (or less) than the dollar (or whatever the correlation market is) would suggest. The cable moves more. It's the amplitude that sets it apart; the increased magnitude of the moves inverse to the dollar. It's typically far more than the fiber's reaction.

Notice that I circled an area on Figure 8.3 to remind you that any correlation can adjust over time. Sometimes the relationship is strong, and other times factors within one or both of the individual countries of the pair can impact the degree to which they move against one another. There are times when both countries can have strong fundamentals driving the currency's strength, simultaneously. In these environments it's not a question of weak versus strong but instead which is weaker or which is stronger. Remember we are trading a pair, which means two individual things, and for a forex trader this means the impact of two countries' sentiments, data, events, politics, and policies. Forex is a comparative market! So right away you can see why I say these are important correlations to know about but that they are secondary to the actual chart of the pair itself.

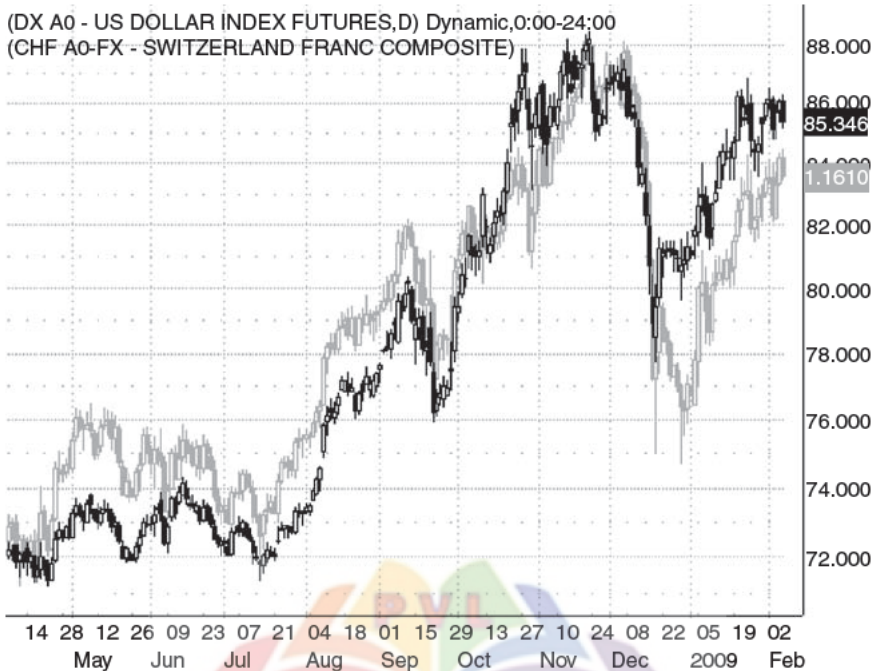
The quote on the cable represents how many dollars you need for each pound sterling. In this case each "quid" will run you 1.4785 in U.S. dollars. The downtrend of the cable on the chart shows the weakness of the quid and the simultaneous demand (strength) for the dollar. In the example of both the GBP/USD and the EUR/USD, you will notice that the pairs both have the USD as the second currency. Within the pair you can switch the placement of the symbol. In other words the GBP/USD is always going to have the GBP first and the USD second. The GBP is the base or first currency in the pair in the forex world, always. This also means that when you look at a chart of the cable and fiber the quote is telling you how many dollars you need for each pound sterling or euro, respectively.

The USD/CHF or "swissy" has a sympathetic correlation to the dollar. This pair has the U.S. dollar as the first or base currency so the quote in Figure 8.4 is representative of how many dollars I will get for each Swiss franc or how many francs I need in order to get one dollar.

Notice that these two markets have a sympathetic relationship. They move together directionally. When the USD/CHF trends higher, this shows dollar strength and franc weakness as it is doing in Figure 8.4.

Never let the charts or the data or any of the trappings of trading distract you from one simple truth: You are trading and watching opinion and psychology unfold, and the representation of that is on the chart you are watching. The minute that you forget that people's emotions move the markets, you will continually be blindsided by the improbable and the unseen. The markets can go to infinity and down to zero. Never believe anything is too high, too strong, too weak, or too low.

Now since we are overlaying the dollar, it makes sense that there should be some analysis made on the market cycle, support, and resistance on that chart as well. In the case of the swissy, resistance on the dollar will equate to resistance on the swissy. The key levels to watch on the dollar are usually simplified if you watch the "00." The double zeroes like 86.00 on these charts and 88.00 are ceilings in the uptrend of the dollar. These



**FIGURE 8.4** The U.S. Dollar and USD/CHF Directional Correlation  
© eSignal, 2009.

ceilings translate to a ceiling on the swissy but floors on the fiber and cable. The amplitude on the swissy correlates nicely with the dollar as well, but remember that the franc itself is subject to internal events, the events within Switzerland, that can affect the pairs' movements. Just because the United States is open and the dominant force in terms of activity does not excuse ignoring movement in the other country factored into the pair.

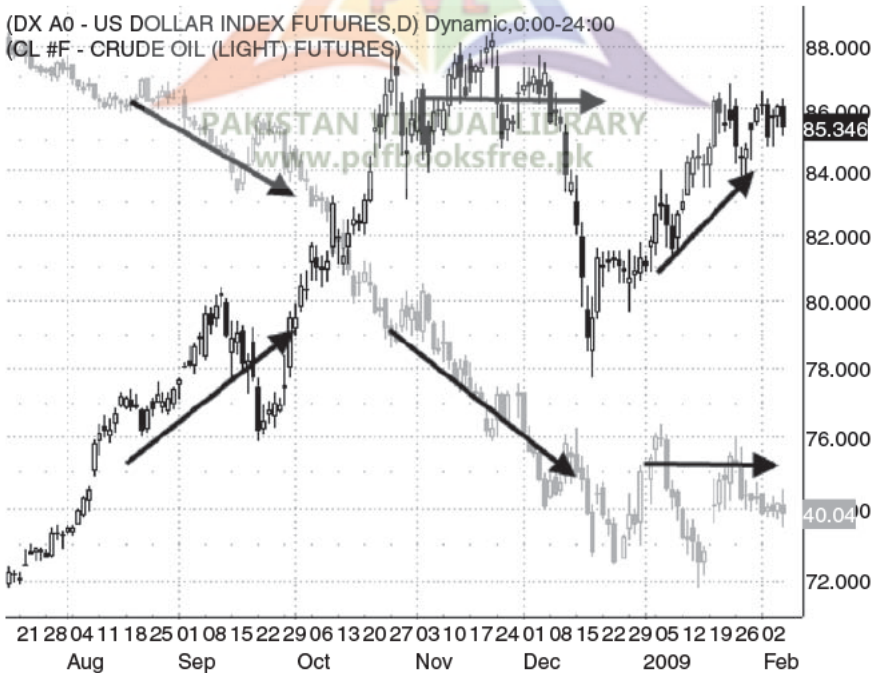
These last four pairs are generally considered the "majors," although the swissy is not always included in that group. I include it only because it's dollar-correlated and trades heavily enough to be considered among the fiber, dollar-yen, and cable. I refer to them even more specifically as the dollar-correlated majors because of their relationship back to the U.S. dollar. There are however six other actively traded pairs that trade against the dollar as well and have their own correlations back to the greenback. These pairs are a little different, though; they are called "commodity currencies" which I feel is a little discriminatory since really all pairs have a certain relationship back to commodities and therefore could all be considered commodity currencies or *comm dolls*. But that's just my thinking, and



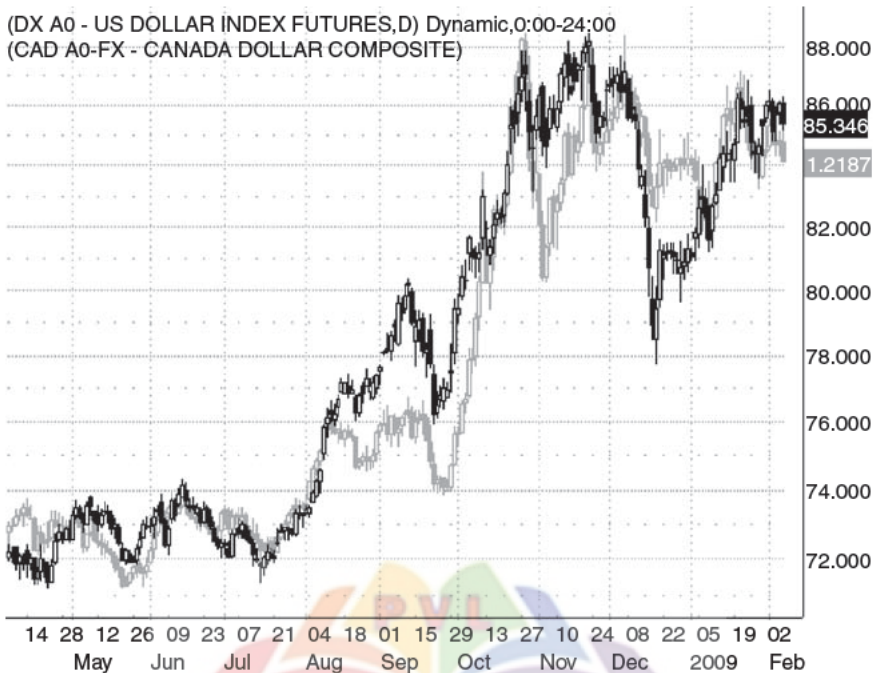
as far as the general opinion goes, the USD/CAD, AUD/USD, and NZD/USD are true comm dolls with correlations that still observe dollar movement but also a commodity alongside. They can behave like spilt personalities, and you have to add the USD/JPY to that behavior.

### U.S. DOLLAR INDEX AND USD/CAD

Since the USD/CAD is the first comm doll, we'll take a look at it. Don't forget that there are two market pulses that can move this pair: the dollar and crude oil. Canada supplies some 9 percent of the world's crude oil, and that's not an insignificant number. Because of this, Canada's economy and therefore a good degree of the loonies' strength, comes from energy exports. When crude oil is strong, the U.S. dollar weakens. The relationship between these two market pulses is generally inverse. As I have shown with the arrows in Figure 8.5, this is not necessarily a set relationship, but it is fairly reliable nonetheless.



**FIGURE 8.5** Market Pulse Correlations between the Dollar and Crude  
© eSignal, 2009.



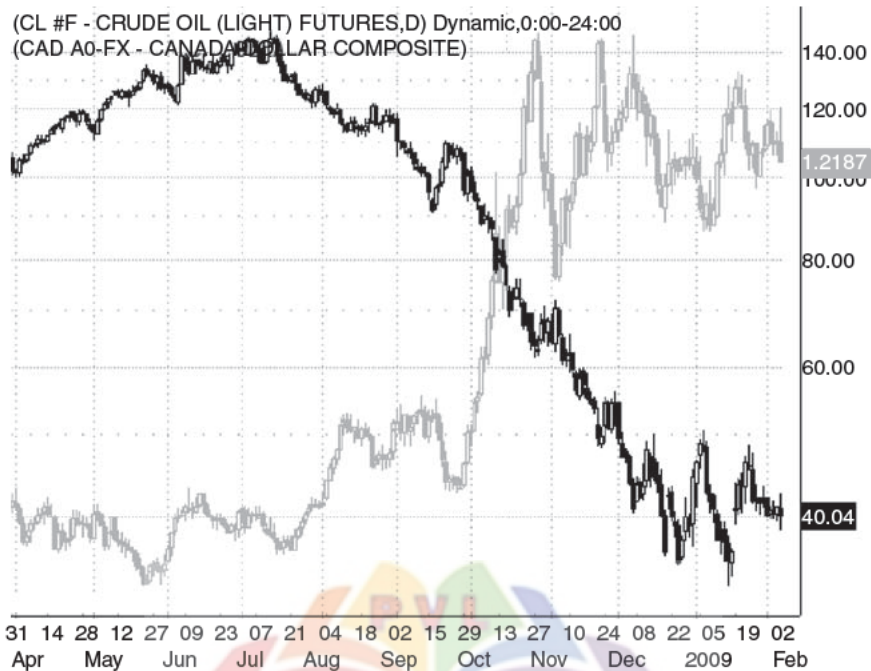
**FIGURE 8.6** As the Dollar Strengthens, the USD/CAD Trends Higher  
© eSignal, 2009.

PAKISTAN VIRTUAL LIBRARY  
[www.pdfbooksfree.pk](http://www.pdfbooksfree.pk)

When you look at the U.S. Dollar Index and the USD/CAD, you will see that the U.S. dollar is the first currency in the pair, and the quote represents how many Canadian dollars (“loonies”) you will need for one U.S. dollar. As this chart of the U.S. dollar trends higher, the chart of the USD/CAD trends higher along with it, signifying that the stronger dollar yields more loonies at exchange (see Figure 8.6). Inversely a downtrend signifies loonie strength over the greenback. But what happens when the crude oil market is strong?

When crude is strong, there is a double effect on the dollar-canada. The strong crude oil market will reflect a weaker U.S. dollar, and this together not only is good for the loonie so it can gain against the greenback, it also weakens the greenback so the net effect is a downtrend on the chart. Now since the crude oil market was weak at the time of this screenshot (moving from over \$140/barrel to just over \$40/barrel) and the U.S. dollar is currently a safe haven currency that has increased its demand, you can see that the chart of the USD/CAD is up, which means weak loonie versus stronger dollar.





**FIGURE 8.7** As Crude Oil Strengthens, the USD/CAD Trends Higher  
© eSignal, 2009.

What are some signals for a reversal? Look at crude oil. If it can rally, that will strengthen the loonie and weaken the greenback and create a net effect of a downtrend on the chart of the dollar-canada (see Figure 8.7). Look for resistance in the U.S. Dollar Index. A weaker dollar reduces buying power and can increase the price paid for a barrel of crude oil. If the economy in Canada improves, this can help the loonie as well. So you see the market pulse has a way of getting you to not only think about the bigger picture of this inter-related market, but it also allows you to measure it!

Strong crude oil means a strong Canadian economy or at least has a bullish impact on it and thus the USD/CAD heads lower.

The USD/JPY was discussed as a dollar-correlated major earlier, and although this is true there is another relationship that it follows with much more reliable, sympathetic correlation. This makes the pair not necessarily a comm doll, but it exhibits that split-personality behavior: in this case with the Dow Jones Industrial Average. I want to give you a little background on the yen and its place as the low-cost currency. The BOJ (Bank of Japan) has kept the lending rate in Japan low for years and even as I write this the rate is 0.10 percent—the lowest among the major central banks. It is the perfect



**FIGURE 8.8** The USD/JPY Reflects Risk Appetite and Risk Aversion  
© eSignal, 2009.

PAKISTAN VIRTUAL LIBRARY  
www.pdfbooksfree.pk

place to borrow from and thus yen are borrowed heavily. In fact, that's the foundation of the carry trade, which I will examine later.

The relationship between the dollar-yen and Dow tells us more about trends in risk appetite (see Figure 8.8). Many traders believe that the yen pairs, like the USD/JPY, are an accurate gauge for risk sentiment. The yen is bought heavily when equities fall. That's at the heart of this correlation. In fact, for you stock traders out there, the yen can act as an indicator to forecast equities movement. This is mainly due to the 24-hour trading time and liquidity of the forex. The best way to determine whether the USD/JPY will track with the Dollar Index or with the Dow has to do with risk aversion. When there is little appetite for risk, the Dow will have better correlation. When the equities volatility is low or there is less concern about the overall safety of stocks, look to the U.S. dollar for correlation. Simply put: weak Dow—stronger yen versus the dollar. The less appetite for risk the more these two charts will correlate. When equities' volatility decreases, the correlation will as well. This is how the relationship between the dollar-yen and Dow ebbs and flows.

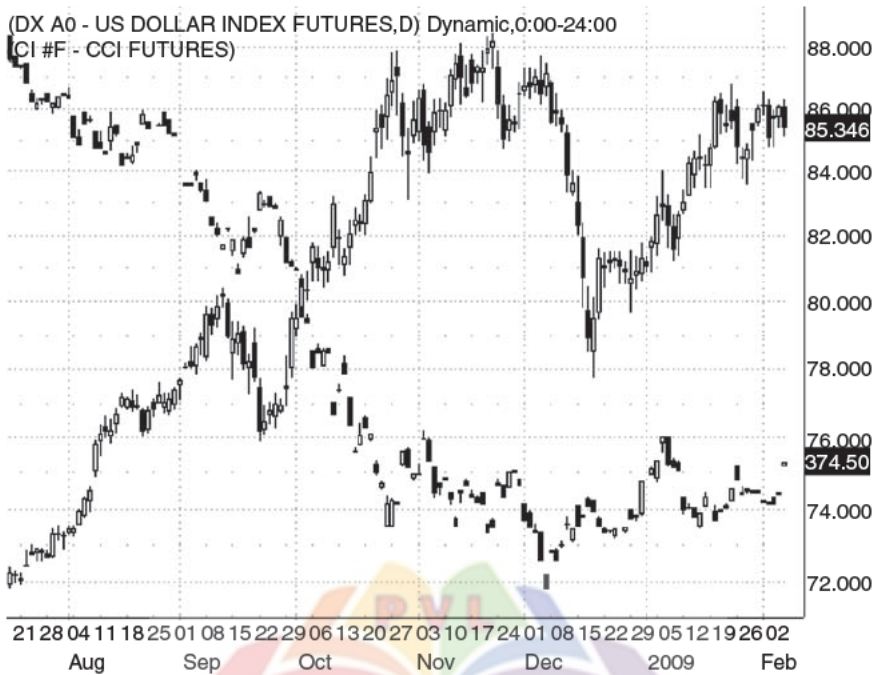


**FIGURE 8.9** Gold and the U.S. Dollar Can Change Their Relationship with One Another  
© eSignal, 2009.

PAKISTAN VIRTUAL LIBRARY  
www.pdfbooksfree.pk

Before we look at the last two comm dolls, the aussie and kiwi, let's take a look at the U.S. dollar versus gold and the U.S. dollar versus the continuous commodity index. These are the markets at the center of the aussie and kiwi commodity currency relationship. Precious metals have long been the markets for a flight to safety and therefore have a relationship back to the U.S. dollar, but in recent years the dollar has represented a safe haven as well, so the relationship has been a unique one and certainly not one that has remained inverse. In the daily chart in Figure 8.9 you can see that the relationship is inverse at times and sympathetic at others. The more you examine these intermarket relationships, the more interesting they can become, but there's no value in delving into relationships just for the sake of examination if there is no actionable idea that you can eventually put to use. Far too much of the technical and fundamental analyses I see on a regular basis loses sight of the fact that at the end of the analysis there should be an actionable idea even if the message is "stay flat."

The aussie and kiwi are typically considered commodity currencies for their relationship back to precious metals. Therefore, since the pairs



**FIGURE 8.10** The CI Symbol Shows Strength and Weakness in Commodities  
 © eSignal, 2009.

PAKISTAN VIRTUAL LIBRARY  
 www.pdfbooksfree.pk

trade against the U.S. dollar, it would make sense that as I look at the aussie and kiwi for gold correlation, it would further make sense that I look at gold's correlation back to the dollar. The problem is that the best correlation for these two comm dolls is not gold alone or even simply precious metals. It is the entire commodities complex, and because of that it's better to look for correlations between the dollar and commodities (see Figure 8.10).

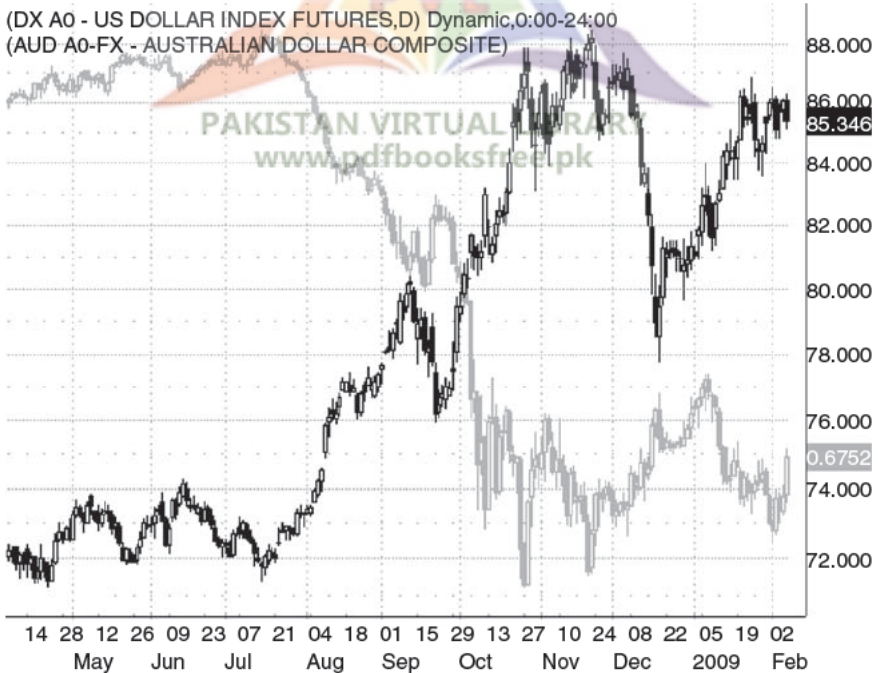
The relationship between the continuous commodities index and the dollar is an inverse one, and when you stop for a moment to consider what the chart implies, it makes complete sense. A strong dollar means purchasing power, and it's this purchasing power that allows us to get more commodities per dollar. A strong dollar pushed the commodities index lower just as it pushes the crude oil market lower. This is a cause and effect relationship, but it is not the only reason that crude, not commodities, moves off course. Regardless, if the relationship is inverse between the commodities index and the dollar, let's now take a look at each comm doll and their relationship back to the U.S. Dollar Index.



## U.S. DOLLAR INDEX AND AUD/USD

The aussie and the dollar have an inverse relationship. As the U.S. dollar weakens, the Australian dollar gains against it, and the chart of the AUD/USD trades higher. The quote of the aussie in Figure 8.11 is 85.34, which means in order to get one Australian dollar, \$0.8534 U.S. dollars are needed. A higher trending aussie chart indicates that the aussie is gaining on the dollar or that the dollar is weakening versus the aussie. I also want to mention that both currencies in the pair do not have to be moving to indicate strength or weakness. It's sentiment as well, and there are going to be times when one currency could not be increasing or decreasing in value, but the other is moving higher or lower against it. Do not assume that a trend in any pair means that both currencies are moving.

The aussie has long been considered a comm doll due to its relationship with precious metals, namely gold. But this is an incomplete assessment. Looking at the overlay of the aussie and gold in Figure 8.12 it is clear that there is not always a strong correlation between these two markets.



**FIGURE 8.11** The U.S. Dollar Moves Inverse to the AUD/USD

© eSignal, 2009.



**FIGURE 8.12** Gold and the AUD/USD Have Changed Their Relationship  
© eSignal, 2009.

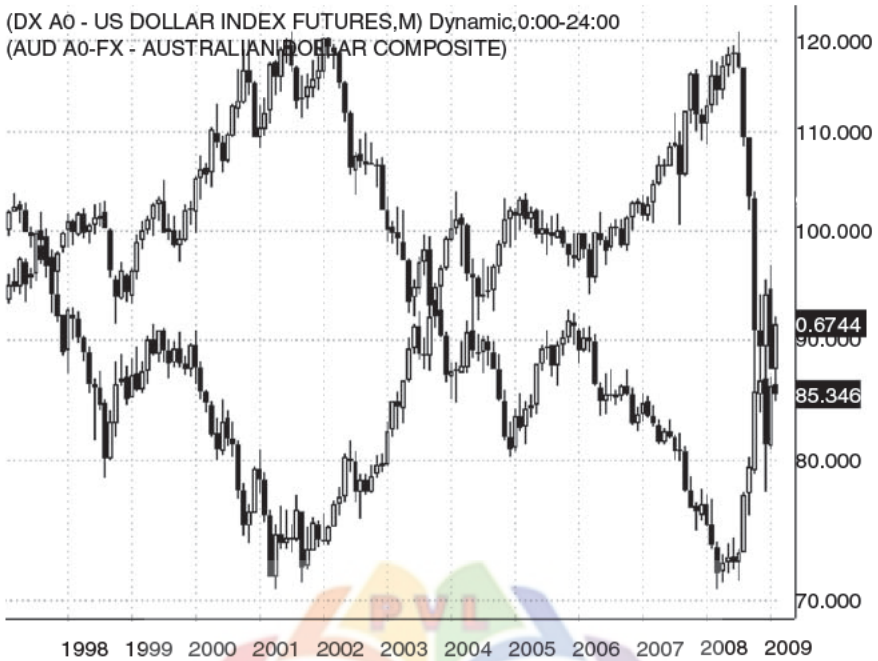
While the relationship has historically been inverse, that does not mean that there will not be times that gold and the aussie will move together.

Looking at the daily chart of the aussie and gold shows this relationship as one that over short periods of time can shift between being sympathetic and inverse. But zooming out to a much longer time frame, the monthly chart where each candle represents the open/high/low/close of one month's worth of trading shows that the inverse relationship is the one that is most common and that sympathetic movement between the two is short-lived (see Figure 8.13).

What applies to the AUD/USD generally applies to the NZD/USD, so I will share the chart overlays here, but they don't need further explanation other than to say that the kiwi moves with and when the aussie does (see Figures 8.14 and 8.15).

Even the gold market, over a much longer time frame like the weekly or monthly, shows a steady relationship. But for trading purposes and for the sake of affordable risk/reward ratios, the daily is as long a time frame that I will enter a trade. So a chart with better, more reliable, and shorter-term





**FIGURE 8.13** A Monthly Chart of the Relationship between the Dollar and the Aussie

© eSignal, 2009.

PAKISTAN VIRTUAL LIBRARY  
[www.pdfbooksfree.pk](http://www.pdfbooksfree.pk)

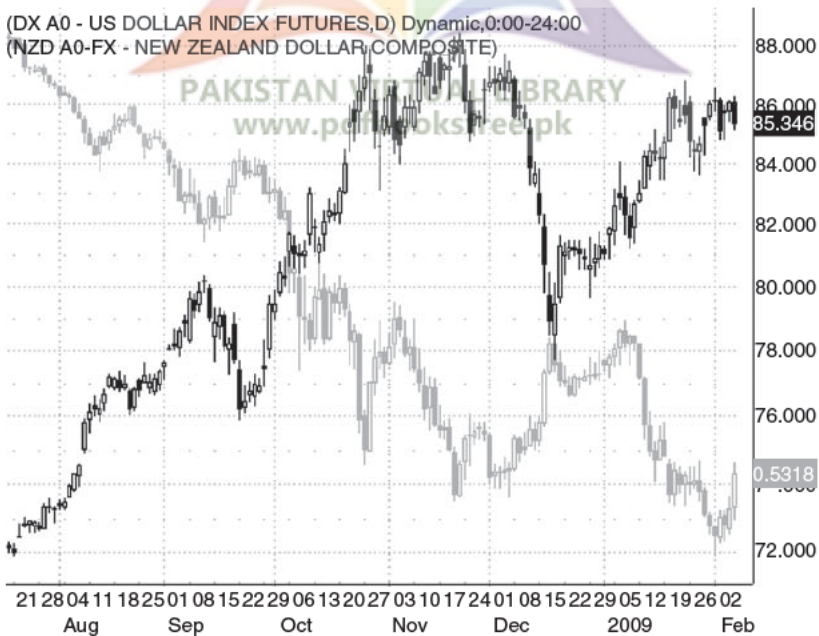
correlation accuracy is required. Enter the continuous commodity index. The sympathetic correlation is indicative of the greenback's strength and hence lower commodity prices and how these lower commodity prices pull the chart of the aussie (and kiwi) lower. This is how the two comm dolls, the aussie and the kiwi, move (see Figures 8.16 and 8.17).

Trading forex—you by now know—means understanding where the U.S. dollar is heading. This may not apply to all pairs but certainly to the six or seven most-traded pairs as they all trade against the dollar. There is no more important a factor when determining any country's currency than the one that comes from raising or dropping central bank rates.

In order to understand what the Fed is going to do with interest rates, look no further than the Fed Funds futures contract. I update my blog with Fed Funds math in front of rate decisions, and you can check this out at [ragheehorner.com](http://ragheehorner.com). The idea here is that if you pull up the contract month specific to the rate decision you see where traders believe the rate will be. In other words, you would look at the March contract for where the expected Fed Funds rate will be in March. Figure 8.18, which is a continuous contract, is representing the current front month, it shows 99.76. The



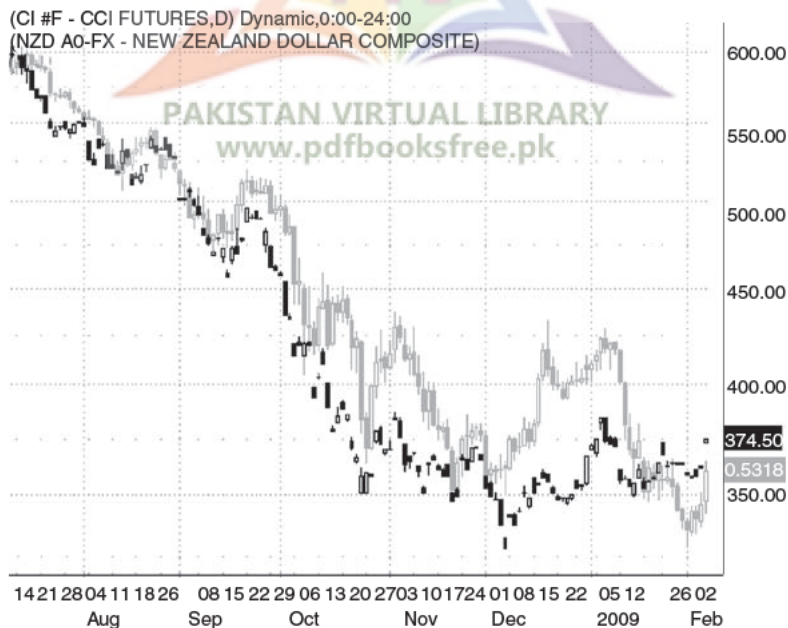
**FIGURE 8.14** The Commodity Index and the AUD/USD Correlate Strongly  
© eSignal, 2009.



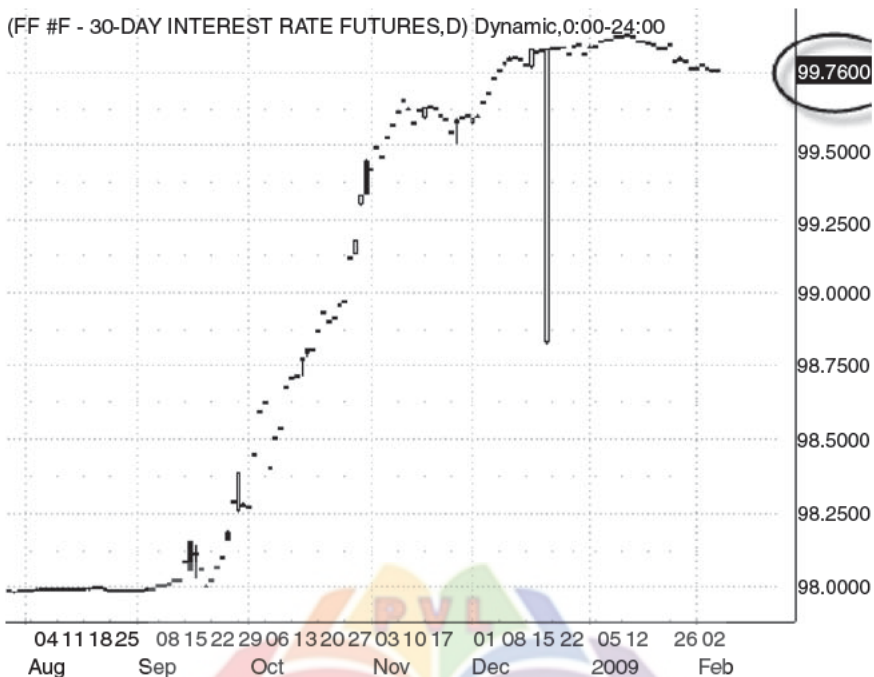
**FIGURE 8.15** The Dollar Index and the NZD/USD Move Inverse to One Another  
© eSignal, 2009.



**FIGURE 8.16** Gold and the NZD/USD Have Changed Their Relationship  
© eSignal, 2009.



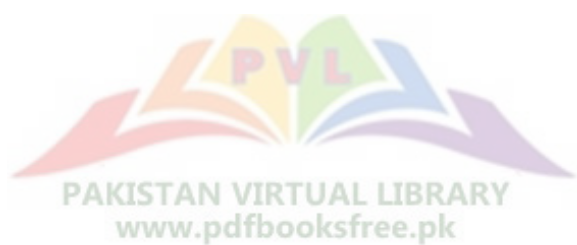
**FIGURE 8.17** The Commodity Index Correlates Better with the NZD/USD and AUD/USD  
© eSignal, 2009.



**FIGURE 8.18** Fed Funds Futures Indicate Where Traders Think Rates are Heading  
© eSignal, 2009.

current front month should represent where traders feel the rate should be. Since the current rate in the U.S. is 0.25 percent, traders feel there will be no change to this rate higher or lower. Here's how I know this: Follow along with me for a little Fed Funds math. Take the current trading price of the FF contract as I have now, 99.76. Subtract 99.76 from 100.00. 100.00 is representative of a 0 percent. 100.00 minus 99.76 equals 0.24. The 0.24 indicates that there is a "no change" opinion, but why isn't it 0.25? The .01 difference between the current rate of 0.25 and the Fed Fund price reflects a very, very slight opinion from traders that there could be another cut. But it's certainly not a widely-held opinion. If it were, the rate would be closer to 0.15 or below 0.10. The closer it trades to 0.00 the more likely traders feel there will be another cut. How about a 0.30 or 0.40? That would indicate that a percentage of traders felt there will be a hike. When the price is sitting on 0.50, that means a 25 basis point hike has been fully discounted or baked into the cake and is what traders expect to see at the next rate decision.

Now you know how to factor in futures changes in the U.S. central bank rate and this is the best indication for overall strength and weakness in the U.S. dollar.



## CHAPTER 9

# Trading Psychology



**Know when to recognize if your opponent is likely to beat the stuffing out of you!**

2006 "Fxstreet.com. The Forex Market." All Rights Reserved.

I've talked about psychology mainly in my live webinars and presentations because I've always felt that I need that feedback from traders—new and experienced—to bring out these issues and memories and experiences. There's nothing like looking out into a group of traders and tell a story and see the heads nodding, or the smiles, or the frowns from a shared experience. The details may change, but the story itself is basically the same. Trading psychology cannot be handed down through stories and techniques alone. You have to live it and have gone



through it. It has to be from the trenches. I can think of only a few rare instances that I have written about psychology. Mainly my experiences are shared with my sister, who has a Ph.D. in psychology, and she's my sounding board. She's able to dissect what I am telling her and give me insight into what I am too immersed in to see for myself.

My sister is the one that got me to begin differentiating between internal psychology and external market psychology. Unlike many trading psychology discussions, where it's only what I am feeling or thinking, here is where I'll break it down into mistakes in psychology based on the market environment and discuss the bigger picture, overall market psychology, and our place as individual traders within this wide scope. Your order entry, your stop loss placement, trends and corrections, support and resistance all relate back to psychology. Think about it this way: Each candle (or bar) on your chart is a representation of fear and greed in the marketplace. If that is the case, I am not actually trading the EUR/USD or the USD/JPY but rather the emotions in that market at the moment. Once you forget this fact, you are no longer seeing what the market is telling you; you are simply projecting yourself onto it.

This will not be a sequential discussion. I will simply tackle different issues one by one. You'll see yourself in some of this and not in others and that's normal because we all have different hang-ups in our market behavior. And that's the point! It's these differences that actually make the market move. Keeping that in mind, here's the first (and in no particular order of importance) psychological point: Consider both sides of the market. For every buy there is a sell. This point actually entails both inner and outer psychology. Most traders do their analysis and in that time commitment to the analysis get so attached to it that they can no longer see *the other side of the trade*. They are so sure that this is the only view that they simply don't recognize that for every buy there is a sell. The very piece of news, fundamentals, price action, chart pattern, whatever that you feel is a reason to buy, can be seen as a selling opportunity to someone else. Remember that you will never be able to execute a trade at any price unless someone else out there is willing to accept your bid or offer at your price. For every buy there must be a sell, and for every sell there must be a buy! So at the precise moment you are buying someone else is on the other side of your trade selling.

When I was in high school and college I had my head (but not my heart) set on being an attorney. I really enjoyed constitutional law. I'd like to have a dime for every time I've heard a parent say, "So-and-so loves to argue, she should go to law school." We've all heard it. I can tell you precisely the day that I figured out how to win almost every argument I had. First was to mentally stop and ask: Why am I arguing? Is there a point to be won here?

If you ask yourself the same, 80 percent of your arguments will stop right then and there. The remaining 20 percent—well, that's where you can only win if you are willing to abandon your ego (the cause for most pointless arguments, and not surprisingly most bad trades) and look at the argument from the other side. In debate classes that I took because I was told they would prepare me for law school, I was the one avidly researching my own side and then just as diligently researching the other. In fact, sometimes I would start to see the other side so clearly that I could make their argument for them. I didn't go to law school, but these lessons have likely served me better as a trader than they likely would have as an attorney.

## **STAY IN BALANCE**

---

Great traders know that for every buy there is a sell and there is a good chance the other side of the trade has an equally good reason for being there. Ask yourself, what is it? Can you see the other side? If you don't know why someone is selling while you are buying (and vice versa) then you are missing something, and that is likely going to make you fall into one of the biggest trading traps: being bullish because you are long, not long because you are bullish. Think about what the other side of the trade is thinking and not just at the entry but throughout the life of the trade.

As we look into inner psychology, you'll continually see that the biggest problem is having to be right or not admitting that you are wrong, which are two sides of the same coin.

The argument about "right" and "wrong" is at the root of not following a stop loss, chasing trades, and a myriad of other bad order entry problems. We are driven by our ego to such an extent that we take trades personally, and so we take winning and losing personally. Most traders won't take a loss because it is so much like being wrong that they will do almost anything to avoid admitting that they made a mistake. But what if you finally understood that a stop loss is akin to being right? Would that change your mindset and behavior, because in fact following a point of validity stop loss is being right!

This is where to discuss only internal psychology and not the way you react to external psychology. Any effort to remove emotion from trading is futile. You are not a machine. So the argument then perhaps might run, "If that is so, Raghee, shouldn't we all follow a system—it has no emotion, right?" That argument would only work if the markets were solely rational. But we know they can be equally irrational. Systems can account for real quantifiable risk, but it's the perceived risk that cannot be measured so easily. That's precisely when you see the academics' point of view in the

market take over at the cost of ignoring the street-level view . . . traders and market psychology are headed off the cliff.

This is not opinion. There is a solid argument that those financial engineers and academics who feel everything can be explained with formulae are missing the point that human behavior, while somewhat cyclical, cannot be forecast to that precise a degree. Human psychology is not formulaic. Consider the evidence: Financial engineers cooked up collateralized debt obligations or CDOs on the “math” that home prices would increase 6 to 8 percent for the foreseeable future! Wrong! What makes this thinking wrong is that growth is not without contraction and contraction comes from perception. Consider that in the 1980s academics thought they had figured out the stock market, selling what amounts to a type of portfolio insurance. Then a quarter of the stock market was lost in one trading session.

Did we collectively lose our common sense when the new math of expansion and forecast growth, with no evidence of sales and increased output, led inflated stock prices? Is this the math of sustainable growth? It was in the late 1990s, and that was the result of psychology, too.

If you feel your analysis, technical or fundamentally based, is 100 percent right all the time, you’re going to find yourself in the tall grass, because your view is not complete. External psychology is about what is going on around you, not just between your own two ears. It’s the culmination of collective internal psychology that creates external psychology. But to assume that you reflect the larger opinion and that your opinion is right is a mistake.

## THE ROLE OF EXPERIENCE

Price reflects psychology. Internal and external. There is a simple way to tackle the sum total of internal psychology, which quite frankly is not nearly as interesting as external. Internal is the “me, me, me.” It is the individual flaws and baggage from past experience we all carry into the market. Why can’t I follow a stop loss? Why can’t I take the trade? Why can’t I react to the move in time? Why can’t I let profits run? Why can’t I cut winners short? I want to tackle the last two questions first because they are the most often quoted market truisms and probably the two most impossible to execute.

Letting winners run and cutting losers short sounds like a perfect one-two punch for winning traders. But I’ve never seen that statement followed up with the next sentence we’re all waiting for: How to actually do it! The internal psychology of that statement results in our belief that it is possible.

But it's an individual definition that will vary from trader to trader with individual risk tolerance. If you are a trader on a five-minute chart, what qualifies as a winner? 10 pips? 15? I see so many traders on short-term time frames—which for me means anything under 30 minutes—who expect to capitalize on the big trends on the four-hour or daily chart. On that time frame, though, it is nearly impossible. That is because a five-minute chart will have more support and resistance levels over the course of each hour than a larger time frame would. The sheer number of candles assures that there will be more touchpoints, and from those touchpoints there will be more levels drawn.

Suffice it to say we would all love to risk 10 pips and make 100. That is both naïve and unrepeatable. Traders who are great gamblers would say that is playing the odds, and once you are on a streak, follow it. That is particularly true and why trend following works. But you have to have a way of identifying the trend and also a way of knowing when it has gone. So essentially letting your winners run is a product of knowing that the market (regardless of the time frame) has begun trending. Cutting winners short is a result of recognizing that the momentum is gone. These are the steps that making these two statements a reality starts with. This is a measure of external psychology. So I hope you are beginning to see how they are inextricably joined.

Inner psychology in my experience can only be helped with the three Cs: Comprehension + Confirmation = Confidence. As I mentioned before, inner psychology is not the most interesting aspect of trading. Character is built in the test, the challenge. You can see your inner psychology on full display when you are up against the wall. You'll see it on display, managing your winners and reacting to trades that don't go your way. I don't really believe a book or course changes who you are. It can improve strengths and manage weaknesses, and that is worth the pursuit, but don't expect to be changed as a person. If anything, the markets will expose the real you more clearly than just about anything else. In many ways, I'll know more about a stranger sitting by their side in a trading office in one session than I could know a friend. I may not know the stories and experiences that shaped my trading office neighbor, but I will know what type of effects they created in his personality. You know yourself. So I will not pretend to even begin to understand what makes you tick. That is your job, and the place that will expose what makes you tick is the market by showing how you react to what it does.

The process by which we learn and then believe is the process of confidence. We all establish confidence in our own time, as some of us need more time to establish confidence in something and others of us need less. This process reflects our past experiences with trust and how badly we want to believe. Desperation usually breeds a quick and false sense of

confidence. You'll see this with traders who are down to the last remnants of their account and need to find things to turn it all around. It's usually scared money, and that's counterintuitive—that scared money wouldn't be more discriminating—but it's true. Scared money won't stick with something too long if it doesn't yield results, but they are often the first to drink the Kool-Aid. They will often act in some ways like a cult. They will need and feed off the optimism of other cult members. You've probably already seen this on many websites and forums. They don't lack confidence, although it may be misplaced, and they are looking for the other two Cs, comprehension and confirmation.

The order in which you have laid out Comprehension + Confirmation = Confidence is important. You must start with understanding something before you can use and then trust it. Again, that quick rush to "trust" comes from—oddly enough—fear and desperation. It also comes from greed. By the way, if you are motivated by greed, let it be the greed for knowledge, not money. I have to say that I personally love greedy traders because they are the fodder for winning traders. I need a loser out there if am going to realize a profit, and greedy traders are always there to try and find bottoms and tops, and come late to the trending party. If you look at price action on your chart and you cannot pinpoint the places at which the "lose" trader is going to be, the loser is most likely going to be you!

Comprehension is the learning curve: the time it takes you to understand and use the methodology you are studying. I say understand and use because just knowing is not enough. You have to be able to do the analysis according to the rules or guidelines set forth by the methodology. If I taught you to swing trade without the Wave, psychological numbers, or Lazy Days Lines, you might still understand the concept of buying into corrections in an uptrend, but how would you define a correction? These are all issues for comprehension.

The time it takes you to understand and be able to use a new indicator, software, entry style, or tool is completely individual to you. Some people learn fast; some people learn slowly, so don't think there is a timetable on how quickly this process should go. We're all pretty impatient, and we all want to learn at an accelerated speed, but don't rush this. While it's tempting to want to automate your analysis at this stage, don't! Learn how to drive a manual transmission before jumping to an automatic.

Take the time to first understand the mechanics of the approach. You can always automate it later, once you understand what it does. For example, I used manually drawn support, resistance, and trendlines for 11 or 12 years before I found a programmer who automated those lines and levels on my chart. I use automation and all sorts of analysis, but I spent the better part of my career doing it manually. I can do it manually if I have to again, but since I have the basic knowledge, I feel comfortable automating



because if the program finds an inaccurate line or level or if Autochartist finds a pattern I don't necessarily agree is a good one, I have the knowledge to catch it and make my own decision. Don't short-change yourself here. Even if you are using a system, which technically means you just plug it in and take the signals (not that I am advocating you do it), you still have to learn what makes it tick. What type of market cycle does it look to capitalize on? What type of risk will it take? How aggressively will it take profits? You see, there are always things you need to make certain you understand before moving on to the next step or more accurately, the next phase. And that's confirmation.

## **TRADING FOR REAL**

---

Before you begin using the strategies you must have comprehension, and you must know what you are doing. While this sounds ridiculously obvious, I can't tell you how many traders skip this step altogether and then wonder where their account balance went. They attend a seminar one day and start trading the next . . .

I don't know how long it will take you to learn, but once you have found you understand the mechanics of drawing trendlines to make a triangle, recognizing market cycles with the Wave, getting in the habit of knowing where price action is in relation to psychological numbers, then you can start trying out your newfound knowledge in a mini or macro account. In case you noticed, I skipped over demo trading altogether, and that's because a demo is only good for taking the time to learn what button does what—nothing more. Demo trading is not a reflection of actual trading results. It never has and it never will. Demo trading takes psychology out of the process because you know it is funny money and therefore it's not real emotion. Demo trading is only a demonstration of the trading platform, not your trading.

Confirmation is nothing more than the process of proving that what you learned is working. The only real way of doing this is with real money. But hear me out; I do not want you doing this with full-size contracts. With mini and micro lots you can use real money but do so with contracts 1/10th or 100<sup>th</sup> the size—smaller winners and smaller losers. If comprehension is the phase by which you train your eyes, then confirmation is when you begin to trust what you are seeing. There is a threshold for each person that you must find within yourself. How much confirmation do you need? It doesn't matter what I need or traders in my office need. It only matters what you need. What is enough confirmation to merit confidence? The amount of past baggage—trading and otherwise—will dictate



this. The more you see something working the way you thought it would, the more you are inching closer to having confidence. By the way, this is a never-ending cycle. It's not as if once you gain confidence it never goes away.

This world was not designed to make anyone confident. It's a choice, and it's a process. It takes active nurturing, and once you get it you can lose it—so guard and protect that confidence because it's more important than any trading tool. You will have confidence in an approach when you see it working.

Here's the most common scenario traders go through, and this is how most traders live out their miserable trading lives: They bounce from strategy to strategy. As soon as one approach stops working, they go on the hunt to find what is working. I'm not saying that you should never look for another effective strategy again, but I am saying that if you are going to go on the hunt, you must follow the three Cs from the beginning again. If traders do this, they will not likely begin the endless cycle of jumping from strategy to strategy. Instead they will add to what is working rather than looking to supplant what was not.

In my experience there are three reasons a strategy doesn't work: (1) user error; (2) the strategy is being applied to the wrong market cycle; or (3) it never worked in the first place. There's not much we can do with the last reason. Strategies like these should be weeded out during comprehension and confirmation. The first two reasons should be worked out in comprehension and confirmation. When a trader never gets around to putting in the time and effort to establish confidence, I can guarantee this trader will be a strategy jumper and never successful in the long run. I would say the number of strategy jumpers probably mirrors the number of losing traders.

So as I said, internal psychology is not that complicated, but it requires monumental effort and discipline. External psychology is studying the market's behavior. If you want to call them the herd or trading public, whatever, it's the collective thinking that moves the market. That's what the chart plots, and that's what we'll discuss next.

The downside is that trading is tough and that our normal reactions to the market are not necessarily driven by the markets alone. That's the bad news. The good news? External psychology and the movement of the herd are extensions of internal psychology, so the better you get at reading yourself, the less your own flaws will shade what you see in the market.

We are our own speed bumps along the road to trading success, but too many traders spend so much time on themselves and internal psychology that they forget the bigger picture. The bigger picture is the herd. How traders perceive something is too expensive or cheap, whether news is good or bad, where to place orders, and when to stop trading—that's all

external. If you're too caught up in yourself, you'll never read the signs of the herd. The herd is actually our friend. We rely on a certain degree of reading the collective mob, and that sociology is right—there are patterns. The problem is that the herd is like sheep: some sheep start moving before other sheep, some sheep lag behind. If something scares a small part of the herd, the whole flock can panic, even though they don't know why. We are sheep. I remember hearing a great line that I think is true: A person is smart, but people are dumb.

## THE PSYCHOLOGY OF MARKET CYCLES

---

We've already talked extensively about market cycles, but I think it merits touching on the psychology of each cycle. Starting with a sideways market, the psychology in a narrow sideways market, known as accumulation, is one of *wait and see*. It is a market of balance, too. When traders agree about the value of anything, there is a balance between buying support and selling resistance. This creates the channel that compresses price. It's the psychology of balance.

Sometimes the market will move sideways but within a wider and more volatile range, and this as you already know is distribution. The psychology and the name of distribution come from the way traders move in and out of the market in a trend. Distribution is the last leg of the trend because the higher highs in the uptrend and the lower lows in the downtrend don't come as steadily. It isn't the balance found in accumulation because buyers and sellers are close in agreement regarding the market's value. The volatility is wide enough that the moves look like momentum, but price is really stuck in a range. This range is the most common to create whipsaw entries, and when in a distribution range, look to fade ceilings and floors.

Trends, whether they are up or down, are imbalanced. When there are more people willing to buy and they are willing to pay a higher and higher price, you get an uptrend. The number of people wanting to buy creates the competitive environment that turns into a seller's market, meaning sellers get what they want through selling at higher prices. Remember that as the competitive environment begins to wind down, so will the trend. Psychologically speaking, trends usually occur in three legs.

## THE PSYCHOLOGY OF NEWS

---

If there is anything that tells me about pain threshold or greed, it's a trader's willingness to trade news. Sure there are big rewards to be had—but there

are even bigger losses. Let's get this out of the way first: I don't trade news. Trading news means that you are setting up an entry specifically to take advantage of the movement that comes from the data release. For most traders this means they wait for the number and then make a quick decision as to whether it is *good* or *bad*. What this really is—is stupid.

Making the decision of a “good” or “bad” number has to do with how the forecast number was discounted into the market. The forecast or consensus number is widely known well before the release and traders basically “buy/sell the rumor and sell/buy the news.” Discounting takes place as traders take what they know to be the expectations, factor that into the market by selling into a bad expectation and buying into a good one. There is also the whisper number to consider, which is harder to find and even harder to discount, since the whisper number can vary greatly versus the forecast or consensus, which is usually pretty similar from source to source.

So when the actual number is released are traders reacting to it alone, or are they reacting to how it reflects upon what they have already discounted or factored into the market? Consider that you bought in expectation of a “good” number and the number came in “as expected” near or at the forecast. You are most likely going to take your profits on being right. If you've ever watched a release, you have seen where numbers coming in as expected can do the opposite. How can a “good” number cause a market to sell off? It does and can because we expected it. There is no reason to buy more unless the result was really good. So what is really good? That's open to interpretation, but suffice it to say, we must be surprised! Surprise is what can move the market with huge volatility. So in order to move a market past what has been discounted, the number has to beat or disappoint in a big way. It's the shock that matters.

So when I say I don't trade the news, while I certainly understand the process and psychology behind news trading, I find it to be difficult to get a good execution as the number is being released and to capitalize on the follow-through in a way that allows for a well-thought-out trade. If a trade decision is made on the spot in reaction to forecast versus actual, how much time can be dedicated to the trading plan? Not much. So this relegates the entire trade to a knee-jerk reaction.

There is little good that can come from this type of trading over time. You may have good trades, and you may (and will likely have) bad trades. But what we're after is consistency. You cannot have consistency with as unpredictable an event as news releases and this means Non-Farm Payroll, FOMC decisions, and really any and all numbers that are typically released between 8:30 A.M. and 10:00 EST.

Here are the criteria you are most often going to look for when trading during economic data releases. Notice I said *during*, and that is very

different from actually trading the release. Trading during a release means that the reason for initially getting into the trade was not based on the release itself but rather a price-based set-up. The set-up is likely to be affected by the upcoming release because of the discounting that takes place as the number approaches. The psychology of the “prerelease” as we’ll call it is one of “wait and see,” and this most commonly creates a sideways or range-bound market. It’s the tall poppy syndrome at work. If you’ve never heard of the tall poppy syndrome, it’s basically the thinking that the tallest poppy is the first to get cut. Tall poppies in the market are the ones who are willing to jump outside the range; they may be the first and the tallest, but they are the first to get cut when the mower (think volatile price action) comes around.

If you have looked at historical reactions to news releases, the reversal is not typical. In other words, look at the trend (if there is one) in front of the release, while the releases may create a wide-ranging candle or series of candles. It does not often create a sustained reversal. In fact what it most often does is continue what the trend was before the release.

## **THE PSYCHOLOGY OF TIME**

Since market cycles and trends are time frame-specific let’s discuss the time frames individually. Most often it will be the shorter-term time frames like the 15-, 30-, and 60-minute charts that begin to consolidate and congest in front of news. These short-term intraday charts reveal the wait and see attitude that is created by waiting for a major event. Bets have already been placed (discounting), and now we wait to see if they will pay off, and this is what creates the sideways market. In front of a report this sideways action is like a coiling spring; at some point it will release. The amount of spring is going to be based on the difference between the consensus or forecast number (what we expect) and the actual (what we get). Often you will see that the longer-term intraday time frames like the 180 and 240 are already trending, and it’s on longer-term charts—and I’ll include the daily time frame here—that the news event may hardly be noticeable. This is a function of the wider trading range that can be seen on longer time frames versus shorter ones. Remember if you are trading off longer-term time frames, news events will often not be an issue at all. It’s the shorter time frames where you will have to be most aware of the volatility.

While my take on the time frames and news reactions are my observations and therefore anecdotal, I think once you look at the price action before and after economic data releases you’ll see how often it’s true. But

what about nontrending markets? That's ideal, but it can be tough to actually get the trigger because I will not take a momentum trigger with the release. I am willing to take the trigger—if it occurs—up to one minute before the release, but the closer it gets, the wider the bid/ask pip spread gets and the tougher it is to get filled. If the trigger occurs later than that, it's a no go. The only entry style that is valid during the release is a swing (trend follow) trigger because I can leave a limit order in the market, and it's the exhaustion of the volatility that I am looking to take advantage of. And that too is playing psychology by recognizing the underlying trend and playing the correction during the price release.

## THE PSYCHOLOGY OF NUMBERS, ENTRIES, AND EXITS

I have been talking about “psychological numbers” for so long that if you've been reading anything I have written you know that it's not just price action that tells the story of the market but also price itself. There is an importance that we as a society have assigned to particular numbers. Specifically, whole, round numbers have an important place in society and psychology. Decade numbers (10, 20, 30 ...), century numbers (100, 200 ...), and even (2, 4, 6, 8 ...) dominate our thinking. It's easy to see the translation to price charts, support, and resistance. If we think in these whole, round, even numbers our order entry will reflect that, and it is order entry that creates support and resistance. Buying is support, while selling is resistance. It's this psychology we see plotted on our charts.

There are ways to capitalize on this and there are considerations from a risk standpoint about having order at these psychological levels. One of the habits I developed as a stock day trader well over a decade ago was that I must “step in front of size” in order to ensure getting my order filled. In a matching system, there are only so many shares to go around. If I want to get a fill, I must make sure that I am near the front of the line, which means sometimes aggressively bidding or offering in front of thicker price levels. Since stocks (and futures to a degree) have transparency, I can see these levels thick with orders. It's a different story in an off-exchange market, but the thinking can often be the same because these levels are very important support and resistance levels.

These levels of increased participation are going to coincide most often with the “00,” “50,” “20,” and “80” levels. The “00” levels are the most important, and there are considerations when set-ups occur near these levels. The most obvious issue is that if prices are approaching a “00” from below the level, then the “00” must be considered resistance, and there is a likelihood that unless there is the volatility of an event moving price, that

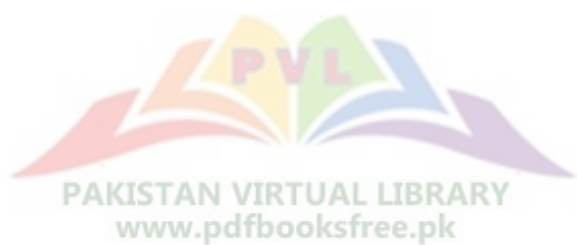


the “00” will initially be a ceiling. If prices are coming down on a “00” from above, the level will be support. The best use of a “00” is when you can use the support or resistance it often provides as an asset to your entry. If there is a short set-up below a “00” or even a “50,” this is an asset because the psychological level is a ceiling. If setting up a buy, a “00” or “50” is a welcome support level.

These same levels have to be considered when exiting a market. Again, remember that the “00” and “50” will be support or resistance depending upon which direction price is approaching it. If I am long and prices are approaching the “00” from below, this level will be a ceiling. The best way to exit the market would be to step in front of the size at the “00” and as prices are rising to this level, I would look to exit at the “95” pip level. If prices are trading lower towards a major psychological level, then the “05” level would be where I would position my order, so that I could exit in front of the size and possible sharp reversal. Prices can turn very quickly and with momentum at “00,” so stepping in front of the size is an important exit strategy.

Consider that if prices can break through the support or resistance at this level there can be momentum in that break, which can carry price further and faster. With entries the idea is not to buy in front of these levels but instead use that same size to help confirm the break and then create momentum. In situations where there is a “00” at or near an entry level, the best course of action would be to wait, even if it means giving up some pips. Enter as prices go through the “05,” level because this is the first indication that prices have moved through. The five pips is not a random number but rather reflects the common bid-to-ask spread. When I want to see that price has been able to break a major level to the upside, I look to see that the bid (support) has taken the level out. It’s the ask (resistance) that I am focused on for breakdowns through levels. Always know where your entries and exits are in relation to “00” and “50,” levels and seek to make these levels work for you, not against you.





## CHAPTER 10

# Psychological Numbers



**What happens in the markets should stay in the markets.**

2006 "Fxstreet.com. The Forex Market." All Rights Reserved.

The easiest static (horizontal) support and resistance you can find on any chart is also the most effective and relevant, and those are psychological numbers. Dow 12,000 ... \$100 crude ... currency parity. There is a certain magic to whole, round numbers. These levels are stealth support and resistance since they are levels that many traders commonly overlook because there is not a visible line drawn there.

Think for a moment why Dow 12,000 is so important or even Dow 8,000—any double or triple zero level for that matter. Does it represent

an important price point in stocks like IBM, Wal-Mart, Johnson & Johnson, which are heavily weighted into the averages? No. If you and I were to make plans for lunch, chances are we'd agree to noon or 1:00, maybe 1:30, right? Why not 12:08 or 12:42? They are perfectly valid times, are they not? But we human beings think in typically even numbers as we prefer 2, 4, 6, 8 to 1, 3, 5, and 7. We also gravitate to numbers that end in zero. This is how we think and behave, and you had better believe this makes its way into market action and order entry. When the crude oil market made its move towards \$150 a barrel, why was this so important, and why did we fixate on that particular number as the high? It was an even round, decade number. In fact as it climbed, each decade number along the way, 100, 110, 120, 130 ... were psychological resistance for no other reason than when traders sit down and analyze the market, whether they use fundamentals or price, they will naturally gravitate to these familiar numbers and put their buy or sell orders there. Really, it is just that simple! You don't have to be Freud to understand market psychology.

This applies to the forex market as well. Keeping an eye on double- and triple-zero numbers can give you an idea as to where floors (support) and ceilings (resistance) are waiting because the buying (support) or selling (resistance) will be particularly thick at these price levels. Add to that another powerful psychological price point in forex called *parity*. Parity is always a double or triple zero number and is even more relevant because it shows a one-to-one relationship between the U.S. dollar and whatever it is being traded against in the pair. Take for example the USD/CAD. Parity is 1.0000, which means that for each U.S. dollar you get one Canadian dollar and vice versa. Parity is not a common occurrence in the forex market, and therefore it's a pretty big deal when it occurs. It's a psychological level that will be support or resistance. How do we know which it will be? Well, if prices are coming down on the parity (or any psychological level for that matter), it will be a floor. If prices are heading up towards one of these levels, it will be a ceiling.

Never assume that just because prices reach a psychological floor or ceiling that the lights will flicker or that balloons will fall from above! Don't assume that price will make a sharp reversal or even rally from that level. Psychological levels like any other support and resistance level are what I call *decision levels*. Decision levels are where traders will consider what they want to do next. These levels are highly actionable as some traders will feel that the level is one to sell while others at the same moment see it as a buying opportunity. What it eventually does has more to do with how this battle between supply and demand plays out. In these cases you and I will wait and watch the fight, like watching boxers in the ring, and wait to see whose arm is raised in the end.

**USING THE HERD**

There are psychological levels beyond the double and triple zeros, although these are the most powerful, and therefore are major psychological numbers. Other levels to watch for are the “50” levels, the “20” and “80” number. So basically any quotes that end in 00, 20, 50 and 80 are psychological levels.

1.5180

1.2000

98.20

0.5450

The “00” and “50” levels are major “psych” numbers while the “20” and “80” are minor “psych” numbers. All will be potential support and resistance, and therefore we need to watch the herd (the overall market psychology) for reaction. When you are aware of these levels, you now have access to instant potential support and resistance and in the Forex in Five world of trading. Psychological levels offer fast, accurate, and reliable price levels we can use for trade entry, exits, and profit targets. It just doesn’t get much easier or better than that! I will show you how to factor in psychological levels when we get into detail regarding actual trade set-ups. I mean we simply just don’t buy and sell these levels, there must be a set-up, and then we factor in available psych numbers accordingly.

I mentioned before that we must wait and watch how prices react at psychological levels; that’s because there really is no way of knowing whether the bulls or bears will prevail. All we know for certain is that there will be a collision here, and that’s how we use the herd.

The herd is the market in general. It’s the mass psychology that moves it higher and lower. We watch the herd because it’s their fear that sells the market off, their greed that rallies it, and their uncertainty that consolidates it. Remember, price charts are not measuring value; they are measuring the perception of value; therefore a price chart is a psychological representation of fear and greed. It is valuable for understanding what the herd is thinking and where they will react. Psychological levels identify these with amazing accuracy.

**THE 200 SMA**

There’s no way we can have a complete discussion of psychological levels without including the dynamic support/resistance of the 200 simple

moving average (SMA). This is *the* most watched and most powerful moving average based on support/resistance levels in any market—stock, futures, forex—when applied to the daily chart. We have already discussed the daily chart as the most psychologically significant time frame mainly because the most important quote in any market is where it closed . . . not where it opened, not where it peaked or troughed, but where it closed. But closes in forex are a bit of misnomer, aren't they? This is the market that never sleeps, awake 24 hours a day. So how is there a "close" that can plot the 200 simple moving average on the close?

Price and the challenges of a 24-hour mark are unique to forex. It's just something we learn to handle and part of that is knowing how the market functions. We discussed trading times and financial centers earlier in Chapter 7, but there are two time zones you must become familiar with, Eastern Standard Time (New York) and Greenwich Mean Time (London).

Most U.S.-based forex brokerages use Eastern Standard Time to reconcile the trades for the day. That's when you'll notice that your profits or losses for the day are realized (applied to your account). Depending on where in the world you live and with whom you have your forex account, this time could be different, so it should go without saying that you should check with your specific broker. The other time zone to be aware of is GMT, as many charting platforms will use this as the close. Again, check with your charting/data provider as to when they call a day's close. As you can see it can be rather random depending upon where in the world you are and who feeds your charts with data! This is certainly going to affect your indicators and the Wave. Luckily the two most relevant financial centers are London and New York and in that order.

All this has relevance going back to how your indicators plot because most of them use the closing price in their calculations, and it's good that you know what and where the close is. Since GMT is London time, and London is the 800 pound gorilla in the forex market—the center of the forex universe—the largest financial center in terms of daily turnover, this works out well. Your close is likely to be focused on either New York or London and therefore reflect the larger majority and influential opinion of the total market and that's why you will find that this not a problem but rather just a fact that I want you to be aware of.

When we look at the 200 SMA on the close, we can rest assured that regardless of the inevitable and slight price difference the line may be plotted at, there will be psychological reaction to that area. And by the way, major and minor psychological levels have an area of variance to them as well. Prices can fall short or move slightly through a 00, 20, 50, 80 level. Falling short or passing the psych number by three to five pips is a common scenario. So don't expect a brick wall reaction, it's more like a safety net.

## 52-WEEK HIGHS AND LOWS

Really, I would love to say nothing more here than *Don't short new 52-week high, and don't buy new 52-week lows*. There is a psychology behind both why people like to try these strategies and why you should fight the urge to do so—even if it means setting up your mouse to give you electrical shocks when you try.

The 52-week highs and lows are psychologically relevant for much the same reason why the 200 SMA is relevant: Because we think they are. When a market makes a yearly high or low, the media, the Internet, blogs, and forums will be buzzing with the news. Heck, even many charting platforms will highlight the pair to indicate the new high or low. Like all psychological reactions, it's the fact that the level is known and public that makes it powerful. The momentum behind this is considerable, since the mood behind the move is one that typically has significant participation.

Participation is a key part of trends and breakouts. No move will be significant without some volume behind it. Think of what a breakout is. Even a small group of buy orders can move a market if there is no significant selling resistance. However, in order to follow through, the upward momentum needs to attract more buyers at this higher level. Because you already know that for every buy there must be a sell, you also know that an uptrend is basically buyers bidding higher for something and sellers all too willing to accept this higher price. If this continues to happen, which it often does in waves of trades, you have a trend.

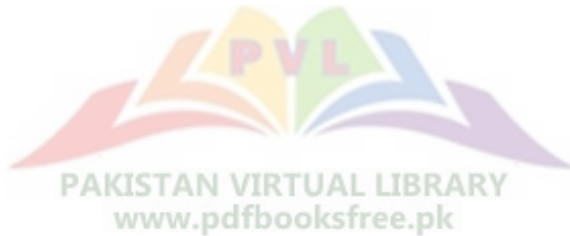
Now consider the heightened state of attention that accompanies a 52-week new high or low. Everyone knows about it, and the psychology is extreme. The momentum carried prices through the ceiling or floor, and then the attention attracts more people who are afraid that they are going to miss a move. Do you want to stand in front of an emotional freight train like this? I don't either! There are ways to play these moves, but as with all trade entries they will depend upon the underlying market cycle. Understand, 52-week high and lows can come from any market cycle.

There are many types of psychological levels, and they all provide a certain degree of support and resistance that you must be ready for. These levels are fantastic because not only are they reflective of the market herd, they are easy to find and really require zero skill to do so! Just knowing they exist is enough, and making sure you know where current prices are in relation to these levels will allow you to capitalize on them. You notice that a key part of *Forex in Five* is market psychology and price psychology. These levels are for the most part fairly objective trading tools. Often the learning curve of trading is not in identifying the mood of the market but in



learning how to use subjective trading tools. Forex in Five traders do their best to use objective tools.

One of the best set-ups that use 52-week high or lows is a simple pattern called a Dow Reversal or Dow 1-2-3. I think that picking tops and bottoms is a low percentage game and an ego-driven trade. But with a 1-2-3 reversal pattern you can take advantage of setting-up weakness after a new high rather than stepping in front of the momentum of a new high or low.



## CHAPTER 11

# Trading Edge



**The markets are your living, not your life.**

2006 "Fxstreet.com. The Forex Market." All Rights Reserved.

Regardless of where you are in your trading, there are certainly aspects of it that you may be looking to improve. We all are. Even as a seasoned trader of nearly two decades, I am still looking for better ways to measure market sentiment, improve my entries, and identify market trends. No trader is ever completely satisfied, but that doesn't necessarily mean we wipe the slate clean and start from scratch. I see far too many traders all too willing to do exactly that every time they pick up a new piece of software, attend a seminar, or read the latest trading book.

There is a point that many traders reach: the point of being completely overwhelmed. The point where there is simply too much information, strategies, and indicators creating the kind of confusion and muddled trading that every trader has experienced. The great traders move through this with the understanding that in the bell curve of learning how to trade, this is where the road to trading success diverges. Winners go one way, losers the other. And funnier still is the fact that the losing path is far better beaten. Did Robert Frost have it right in “The Road Not Taken”? At this point in a trader’s learning curve the process of removing what doesn’t work—not necessarily adding to it—is what is required. In a world of more, better, and more still, there is little that encourages the concept of less and minimal.

That brings me to the first and best form of charting analysis I have come across. It isn’t new, it isn’t fancy, and it’s still considered a newbie’s methodology. Why? To embrace the simple and straightforward has somehow been taken to be ineffective and inexperienced. I am a very experienced trader. I don’t say this to impress you but rather to impress upon you that using tools that you may have learned early in your trading career may well have been the best strategies you were ever exposed to. Yet, as a misplaced rite of passage, traders discard these strategies in favor of increasing complex and sophisticated tools, software, and systems.

I don’t intend this to be a discussion of trading psychology. While that’s certainly important, if I may share my opinion, it’s overdone. There are, as we discussed, two forms of psychology, inner (what you are interpreting and acting upon) and outer (the larger market psychology or the herd). The latter is easier to decipher. The former is a project, a lifelong task that will likely never end. But I can again give you the formula: Comprehension + Confirmation = Confidence. Inner psychology is about confidence. Confidence is precisely what most traders lack. By confidence, I mean confidence in the methodology of trading. Many, many traders find something complicated as though it were a shiny, new toy. Maybe it’s the mystery and complexity that’s so intoxicating. Seriously, good trading has and will always be simple.

Early in my trading I discovered chart patterns through Richard Schabacker’s *Technical Analysis and Stock Market Profits*. Richard Schabacker’s work was well known by the 1920s. The book itself was first published in 1932. I think all of us at some point were introduced to chart patterns at one time or another. Most traders quickly dismiss these simple patterns as being for newbies and then go on to “graduate” to a hapless and fruitless trading career. Why discard these gems? I’ve mentioned them earlier, and I’m mentioning them again because of their profound importance for any trader who aspires to prosper in the markets.

If you have tried using chart patterns in the past, you may have had hit or miss luck with them. That's mainly the reason why anyone discards anything. It doesn't work. The remainder of the reason lies in a basic human trait: the search for something better. This unknown may exist on some levels of living, but not in trading. What's best for you may not be best for me. "Best" is relative.

Remember a couple basic ideas of price:

1. News and fundamentals are built into price action.
2. Price action reflects the psychology (think: fear and greed) of the market.

I am not a technician (technicians rely more on indicators, which are always lagging), but rather I am a chartist who focuses on price. Nothing leads price. Some tools like pivot points and Fibonacci levels may forecast, but this is not predicting.

The other aspect of price that no one seems to tell anyone—so I'm going to tell you now—is that price can only be interpreted effectively if the underlying market direction is identified. It was reading article after article written by Charles Dow that crystallized this for me. The market currently is in one of four market cycles: accumulation, mark up, distribution, mark down. A market, you have learned, can only travel up, down, or sideways. This is not enough, though. We must know how to identify the current cycle in real time.

Now take this concept back to what may have been a hit or miss relationship with chart pattern-based entries. Occasionally, I can imagine, they worked, and occasionally they did not. In all likelihood you were by chance pairing trending patterns with a trending market and sideways patterns with sideways markets. Eventually the frustration of this haphazard winning and losing made you drop chart patterns and move on. *They're for newbies after all*, you may have huffed as you went to Google to search out your next trading strategy.

So what do we know now? Chart patterns must be paired with the correct market cycle. Here's how you can use a simple trio of three Fibonacci-based moving averages to accomplish this. I call it the "Wave," as you now know. The Wave, to recap, is three 34-period exponential moving averages, one set on the high, one set on the close, and one set on the low. These lines will travel up, down, and sideways across your charts. When they are used in the proper reference, you will have what I call a *clock angle*. For example, if you are trading off a daily chart (also known as an "end of day" chart), ideally you should be looking at a year's worth of data. This amount of data does a few things for you. First, it will put

all relevant price action front and center: recent trends, 52-week highs and lows, and reversals. Second, it will allow you to take a proper clock angle reading, which means that the year's worth of data compresses price action into the right scale so that when you look at the angle of the three lines, it's an accurate reading of the cycle the market is currently in.

Let me mention right now that while I will be using chart patterns, there is not a trader alive who couldn't benefit from an accurate and real-time reading of the current cycle of the market. It's not limited to any style of trading. In fact, it's the very reason you should be utilizing one type of entry over another. All entry styles currently are designed for trending, reversal, breakout/breakdown, or range-bound cycles—whether you know it or not! So the first thing you must determine about your current stable of entry strategies is what cycle was it meant to capitalize on. No single entry strategy can capitalize on every cycle. That's a fact.

When it comes to trending versus nontrending patterns, it's fairly easy to determine this with the chart pattern name. Falling wedges and down channels are, as their name implies, downtrending patterns. Rising wedges and up channels are uptrending patterns. I mention this because many times traders find the lines and levels that form a pattern and then go straight to entering a trade based upon those boundaries. The problem with that is the missing step. In order to use a trending chart pattern set-up correctly, the underlying market must be in a trend. Except for the Wave, I know of no other way to do this in real time.

As shown in Figure 11.1, the 15-minute USD/CAD is heading down at what I would call a four to six o'clock angle. This is also a mark down or downtrend. The downtrend would be a perfect pairing for a downtrend chart pattern like a falling wedge or down channel: not however for a triangle, rectangle, double or triple top or bottom, as these are examples of sideways or range-bound patterns better suited to an accumulation or distribution cycle. See Figure 11.2.

This is not limited to short-term intraday chart analysis. How about a longer-term, end-of-day chart of the EUR/USD? See Figure 11.3.

As shown in Figure 11.4, this is a down channel and must be traded in a downtrending market. So finding the pattern is step one. Confirming that this pattern is occurring in the correct market cycle is step two. Now realize that chart patterns are simply the combination of downtrend lines, uptrend lines, horizontal support, and resistance. This channel is two downtrend lines. Has it formed in a mark down cycle? Use the clock angle of the Wave to determine.

This market cycle filter or confirmation step can be applied to any type of trading as long as you know which market cycle your strategy was designed for. This is something that most traders don't consider, mainly because they are seldom told to. Traders usually define themselves by their



**FIGURE 11.1** Confirmed Downtrend with the Four to Six O'clock Wave Angle  
© eSignal, 2009.

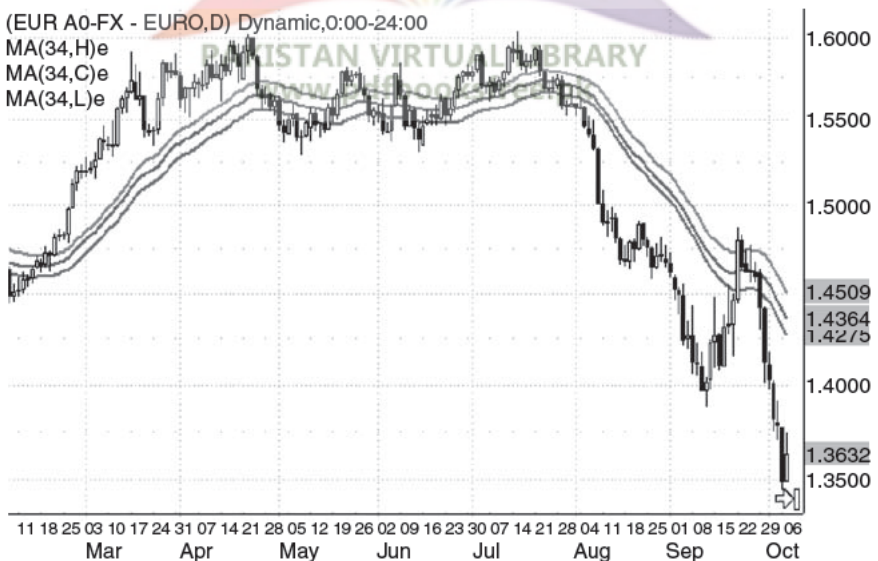


**FIGURE 11.2** The Falling Wedge Pattern Should Only Be Traded in a Downtrend  
© eSignal, 2009.

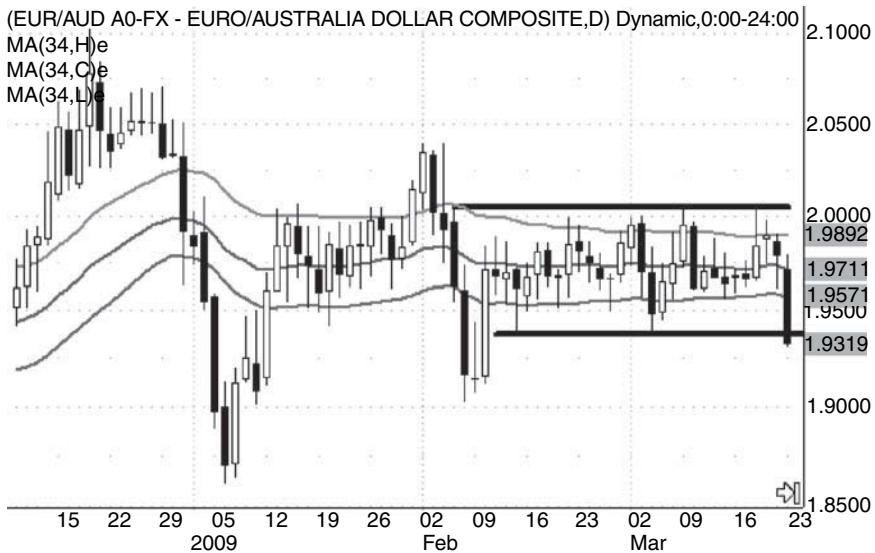




**FIGURE 11.3** Two Parallel Downtrend Lines Form a Down Channel  
© eSignal, 2009.



**FIGURE 11.4** The Down Channel Is Only Valid in a Downtrend  
© eSignal, 2009.



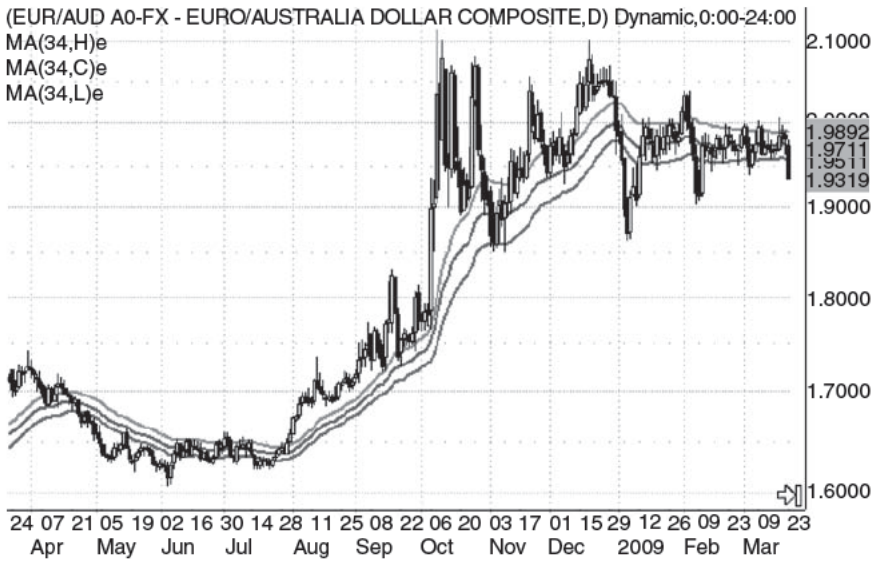
**FIGURE 11.5** Rectangles Are Consolidation Patterns  
© eSignal, 2009.

trading entry style: “I’m a swing trader” or “I’m a momentum trader.” This is only half true. When the market cycle is sideways, only then should you be a momentum trader. When the market is trending, you should look for swing entries and trending patterns. Let the cycle dictate your entry!

Let’s look at a sideways pattern. This one is an interesting look at what could be one of two choices. A few things to take note of: Do you see the width of the pattern? The range from the horizontal resistance to the horizontal support is wide enough to merit trading within the range. See Figure 11.5.

Inside the range trading is a strategy that takes advantage of wide sideways patterns like this, with static (horizontal) levels that can be shorted at the ceiling and bought at the floor. Alternatively, a breakout/breakdown play can be set-up that would entail waiting for price breaking up through the ceiling or down through the floor. Of course, this pattern must be confirmed by a sideways market cycle. See Figure 11.6.

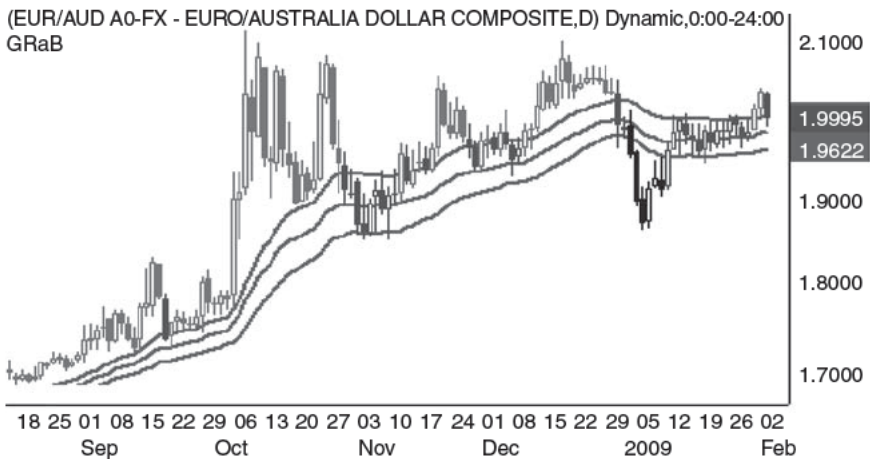
In each of these examples, the chart pattern was only considered a potential entry after the market cycle confirmed that the pattern was occurring in the appropriate cycle. Without this confirmation, the lines and levels of the pattern could potentially be acted upon incorrectly. No matter what your trading style, understanding which cycle your strategies are most likely to succeed in will increase the chances that you’ll be on the right side of price action. See Figures 11.7 and 11.8.



**FIGURE 11.6** The Wave Indicates a Sideways Market on the Daily EUR/AUD  
 © eSignal, 2009.



**FIGURE 11.7** Chart Pattern Identification Automated by Autochartist Software  
 Images © Autochartist.



**FIGURE 11.8** Confirm the Rectangle with a Sideways Wave  
© eSignal, 2009.

## THE RIGHT SIDE OF THE CHART

As traders, the only reason we need to know what has happened (the left side of the chart) is to determine what will happen, and that's the right side of the chart. Too often we get caught up in discussions of why something happened. But when it is not balanced out with a discussion of how this will help us figure out what will happen, it's simply a mental exercise and not trading. I see plenty of cocktail party analysis on the Web. I strive to join their party because even if I go off on some fundamentals-based discussion of the market I hope my better angels will bring me back to what is actionable about it. Actionable analysis is something that is not commonly found. Actionable analysis is about telling the reader what you think will happen, how, and why. It takes guts to be specific about set-ups and price. That's what it means to focus on the right side of the chart.

Cocktail party analysis is almost always either very long term (at least a one- to two-year time horizon) or refers to the left side of the chart. Fundamentals are almost always left side because data is backwards-looking. There is no piece of data—Non Farm Payroll, Unemployment, Retail Sales, Gross Domestic Product—nothing, that will lead the charts. If you know of a fundamental that is bullish in nature, you can be assured that it is not the only one—not that there isn't a bearish piece of data out there, too. The trick is to understand what is actively being discounted at the moment.

There are certain relationships that the market will look at. The Dow and USD/JPY is one such relationship.

## CONSUMER CONFIDENCE

Has all the negativity of the stimulus plan been reacted to? Has it— at this point in the media and public— been fully discounted into price? It can be agreed that we're going to spend over a trillion dollars of taxpayer money and we're going to do *something* versus nothing. There are two things that can be of benefit and that is to not do more damage to the economy and inject optimism via capital into the economy, but more specifically, the U.S. consumer. If consumers think the economy is turning around, they will buy, and that's what's going to improve the economy. Not better data. Data is lagging. Consumer psychology will be leading. Because of this, the consumer will feel better before the data looks better.

I was speaking to a friend of mine who works for a fund and decided that in an “alternate universe” Treasury Secretary Timothy F. Geithner announced every last detail of the plan and the equities market sold off all the same. The reason is that Wall Street ran the market up (discounted the announcement) and the only surprise would have been (1) no announcement or (2) that the United States won some intergalactic lottery and thus paid off the debt. In other words, no matter what, the equities markets were going to sell off.

I mention all this because it has a direct effect on the USD/JPY. Is the current price action the beginning of a sideways/bottoming cycle? Let's dissect the daily chart. Starting with the green, red, and blue or GRaB charts, there is confirmation of the sideways cycle transition on the daily with the 34 EMA Wave indicator moving sideways, indicating a transition to an accumulation or distribution market cycle. See Figure 11.9.

Currently the Fibonacci levels on the daily USD/JPY showcase a solid double bottom at 87.10 to 87.12, which can at very least establish a short term floor. The ceilings are identified by the 25 percent, 38.2 percent, and 50 percent Fibonacci retracement levels. See Figure 11.10.

One floor and multiple ceilings could contain both further upside and downside on the USD/JPY as there are significant arguments that the negativity in the Dow has been fully discounted. If the 87.10 to 92.25/93.83 area is going to be in the consolidation range going forward, then that indicates that the Dow will consolidate here as well.





**FIGURE 11.9** A Transitional Market Cycle on the Daily USD/JPY



**FIGURE 11.10** Fibonacci Identifies Potential Floors and Ceilings on the Daily USD/JPY





**FIGURE 11.11** An Autochartist Symmetrical Triangle on the Daily USD/JPY Images © Autochartist.

## RISK APPETITE

The USD/JPY is approximately six days into a market cycle shift into accumulation. There is now a chart pattern alert to reinforce this shift, and while it may not immediately usher in a return of risk appetite, investors' stomachs are beginning to growl. See Figure 11.11.

The trendline to keep an eye on is the downtrend line (the green resistance line) on the asymmetrical triangle pattern. This congestion pattern is currently trading near the downtrend line with the breakout level just below the 92.00 major psychological level at 91.84. See Figure 11.12.

The bias for a breakout can be tempered with the fact that the Dow is still below 8,000 but, focus on the signals from the daily USD/JPY. There are reasons to look for higher highs, but the bullish engulfing is one. See Figure 11.13.

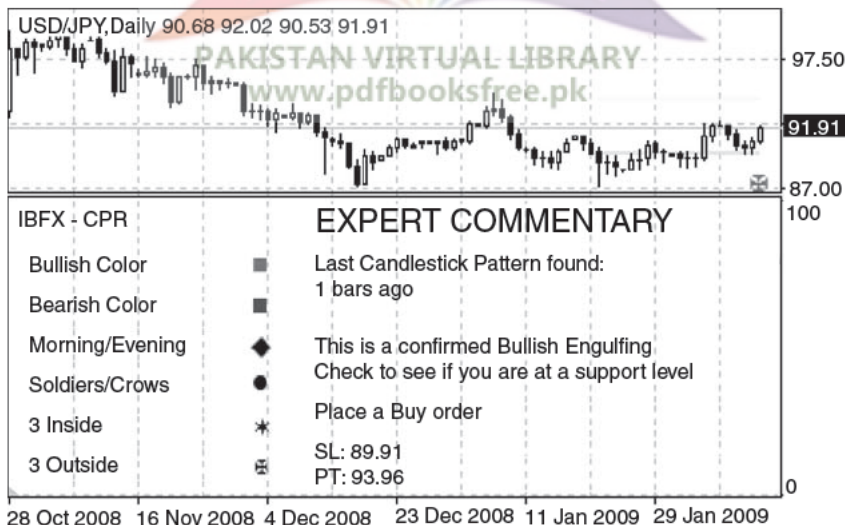
This all means that there are still ceilings that the USD/JPY must trade up through before the sideways market cycle can transition into proof that risk appetite has returned in equities and that the USD/JPY will trend higher to reflect that. It's a major shift in investor psychology we're waiting on now.

## SELL THE NEWS

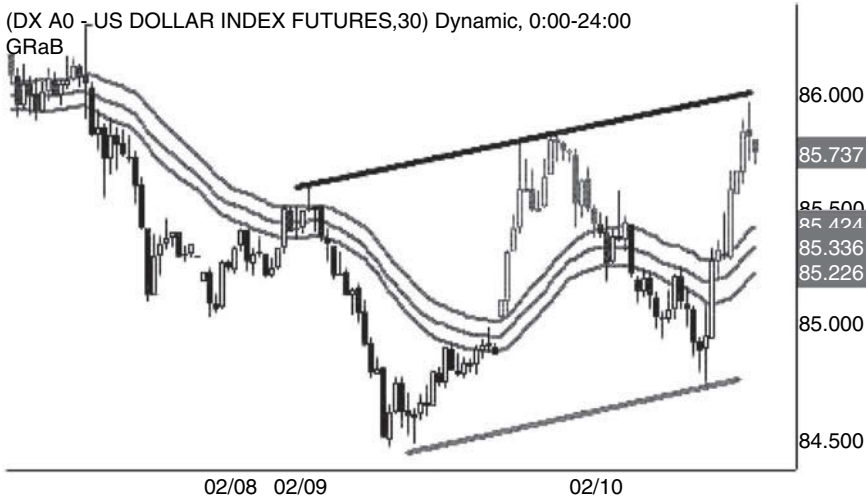
The Dow is currently down significantly mainly on a "buy the rumor, sell the news" response to the release of the stimulus package on what seems



**FIGURE 11.12** Re-creating the Pattern Lines and Levels on the Live Chart of the USD/JPY



**FIGURE 11.13** Using MT4 Plug-ins to Find Candlestick Patterns



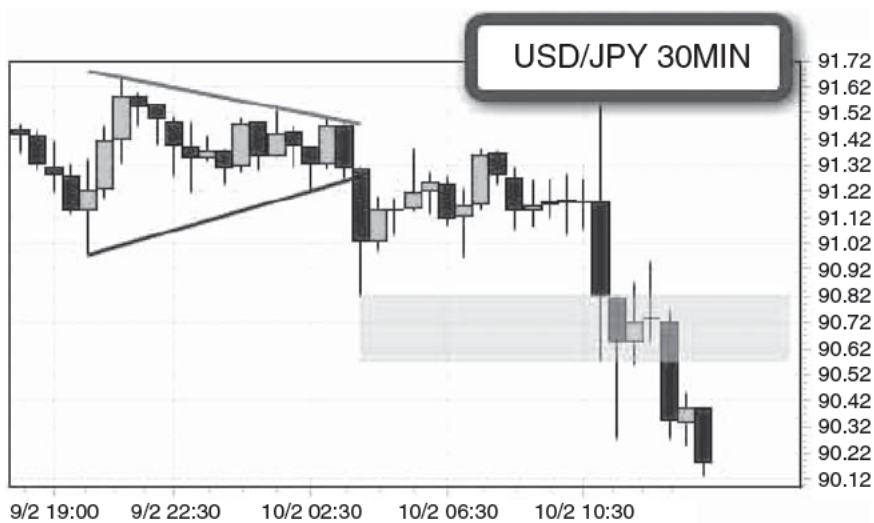
**FIGURE 11.14** An Intraday, 30-Minute Chart of the U.S. Dollar Index Futures Contract  
© eSignal, 2009.

to be a calculated lack of specifics from Treasury Secretary Timothy F. Geithner for how the plan will be executed. The street hates uncertainty more than bad news, and there are plenty of questions, leaving traders rallying the dollar in a continued safe haven play. See Figure 11.14.

With a dramatically weaker Dow and U.S. Dollar Index rallying from below 85.00, the dollar-yen is trading lower breaking out of an earlier triangle pattern that had formed during Tuesday's Asian session and broke down with the Frankfurt and London open. See Figure 11.15.

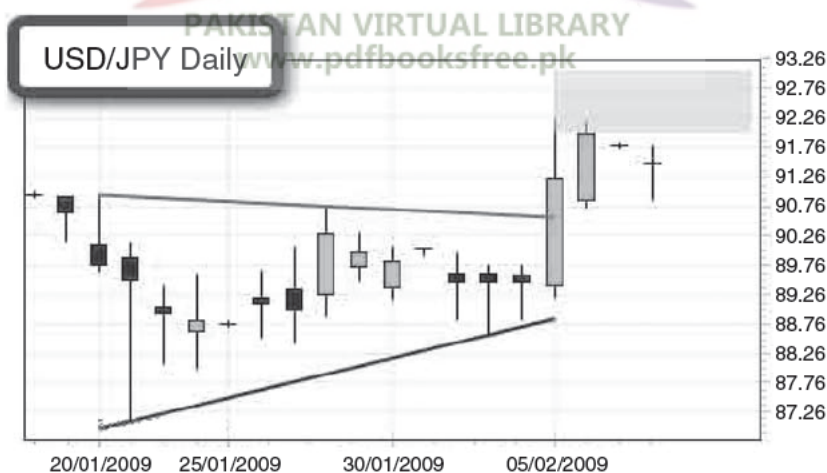
The USD/JPY broke higher last week as equities rallied in front of today's news. The process of discounting (otherwise known as "baking into the cake") is vital when trading yen pairs when there are events that will affect the U.S. equities markets. The breakout higher did follow through to the forecast region as plotted by Autochartist in Figure 11.16. Forecast regions can be valuable support and resistance areas that traders can take cues from to identify potential reversal or stall points on a chart.

The very ceiling the forecast region plotted was where the 30-minute chart began consolidating and where the triangle pattern developed. As a general rule, the USD/JPY will continue to fall as long as the risk aversion that permeates the equities market continues. Furthermore, this lack of risk appetite will continue to make the U.S. dollar the world's safe haven currency. The stimulus plan put an exclamation point on the feeling investors have about U.S. stocks and their fear of further decline. Gold has



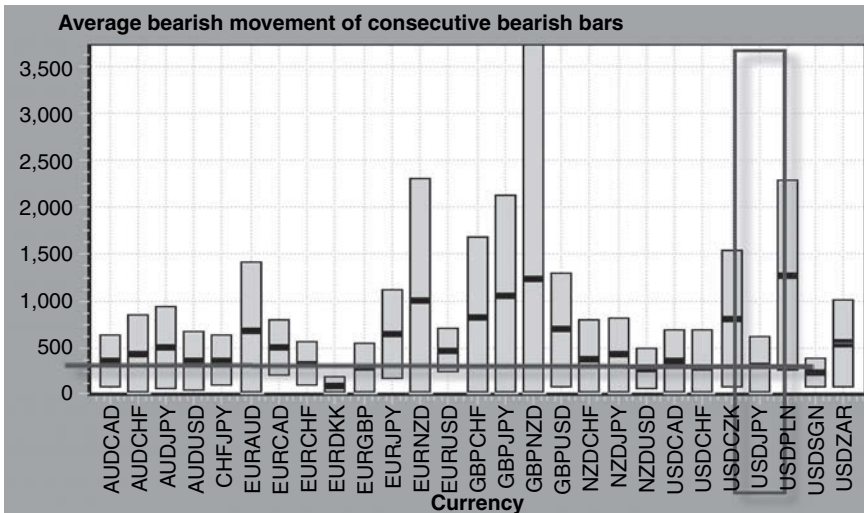
**FIGURE 11.15** Autochartist Identifies a Triangle Pattern on the 30-Minute USD/JPY

Images © Autochartist.



**FIGURE 11.16** A Triangle Breakout Follows Through to the Ceiling (Shaded) on the Daily USD/JPY

Images © Autochartist.



**FIGURE 11.17** Using PowerStats to Gauge Expectation for USD/JPY Movement

rallied up to \$920/oz. as an indication of continued concerns and disappointment in the plan's overgeneralized unveiling.

On an interesting note, daily bars on the USD/JPY average approximately 300 pips. See Figure 11.17.

Today is the second bar of bearish price movement. With a high of yesterday's session of 92.42 and today's current low of 90.10, the number of total pips lower is 232 pips.

## CHAPTER 12

# Is My Broker Friend or Foe?



**Sometimes the best position in the market is not having one. Learning to walk away from a difficult market, a bad mood, or a tough day is often the best lesson a trader can learn.**

2007 "Fxstreet.com. The Forex Market." All Rights Reserved.

One of the most common questions I get is whether brokers run stops. I'm not a broker, but I have to say that sometimes this question starts to take on a mythology like an *X Files* conspiracy theory. Stops are run in any market where market makers or pit traders or whoever can anticipate a large number of orders sitting at a fairly predictable price level or area. It's like shooting ducks in a barrel... not that I have anything against ducks.



What's interesting is that many traders feel that someone is out to get them. In a zero sum game, that feeling of suspicion is not entirely misplaced. Someone is on the other side of all trades because for every buyer you need a seller. In forex, since there is not a centralized exchange, your broker is your liquidity provider and therefore is taking the other side of your trade. I am simplifying this, but that's the gist of it. Now if your broker gives access to a large pool of liquidity providers as there is a new breed of brokers that don't take the other side of your trade but rather routes your order to a larger pool, it is someone else who will take the other side of your trade. Many traders feel more comfortable with this arrangement, where the broker doesn't have a trading desk. Either way, someone out there is trading against you.

I hear of lot of traders saying, "When I buy, the market automatically goes down" or "They are moving the market to take me out."

"Okay, so what kind of size are you trading?"

"Two mini lots."

Right, they are paying people to trade against your two minis. What is more likely the case is that the entry is coinciding with the herd and it's your two mini lots plus the herd that comprises a reason for the market to fade the move. Perhaps the orders are sitting at a psychological "00" or "50" level. There are a number of reasons that particular price level can and will cause reversals, especially when the level is thick with orders. In those cases, it could be considered *running stops*. I won't argue with that. But I will say that it is our job as traders to know where our orders are in relation to the herd!

So what's a trader to do? First, recognize where you are in relation to economic report releases. Time is the most overlooked aspect of forex trading. The assumption that all 24 hours are created equal, that somehow you can belly up to your computer screen at any time of day and begin trading is wrong! Price is another misunderstood aspect; there is a psychology to price itself and price action. Always know where you are in relation to the "00" or "50" pip levels as well as the "20" and "80." Another error is trading news. I tell traders that if you are going to trade a release or if your trade will be open during a release, you're going to have to do one of two things: either get out of the trade or use a time-based stop instead of a price-based stop that can potentially be hit during the volatility. Some brokers will really milk news releases with terrible spreads and/or late quote updates. News can create volatility. You should know that. Time-based stops allow for the craziness to subside and the price action to normalize. I call time-based stops, "60 second stops" because for 60 seconds after the release, I take my stop out of the market. These are the most common oversights. Now some people may dismiss this as my sticking up for brokers. I'm not. I do think that they know what typical habits are of traders. I think they

understand order flow and price action and the psychology behind them well enough to simply capitalize on the stupid things that many, many traders do. The only way we traders won't do those things is to first recognize what those things are and then have the discipline to avoid them. I do think that many traders simply want someone to blame brokers for their bad trading. Don't be one of them. Take responsibility for your actions and focus on those things that you can control. Buying into the conspiracy theory mentality will only make you trade like a victim, and that is *not* how you want to trade!

## THE 2 PERCENT QUESTION

*Hello, Raghee, could you give me your comments and suggestion on risk management? What is your position on the rule that many traders have, that at one given point you should not risk more than 1 to 2 percent of your total account value? Is it true that if I have a \$10,000 account I should not risk more than \$100 to \$200 in a trade? And what about placing orders on correlated pairs like the USD/CHF and EUR/USD at the same time if the conditions on the wave, support and resistance are good?*

PAKISTAN VIRTUAL LIBRARY  
www.pdfbooksfree.pk

Thanks,  
Luis

These are great questions. A lot of traders have the same ones. You know by now that I believe risk management is more of a psychological issue. I think that following a stop loss has everything to do with discipline and little to nothing to do with a percentage or number of pips. Most traders do not follow their “formula”-based stop losses because they frankly don't mean anything. It's easy to move the placement or ignore it when there is no meaning attached to why the stop loss was placed at a particular price point. How about using a 30 pips-based stop? Why not 35? It's just too easy to move when they are arbitrary or based on a number or percent. This is taken from years and years of self-observation and teaching hundreds of students up close.

I also don't like the idea because it somehow insinuates that trading is like gambling or craps, which in some ways I acknowledge it is, but I believe there is less left to chance when trading. Friends of mine who are great traders and gamblers succeed because of discipline and knowing when to vary their bet size. That's not luck or a formula; that comes from identifying when the momentum is on your side.

Now, contrast that to determining a stop loss . . . there's an approach there. It's one that involves the idea that every trade has a point at which it is invalid. The point of validity is the point at which to buy or sell is no longer a trade worth holding because something has changed great enough in price to change the reasoning for the entry. Notice I did not mention a percent or number (of pips).

Now, I agree the 1 or 2 percent can be a threshold. Certainly there are entries that when considering where the point of validity is, could represent too great a risk (potential loss) to your account, and those trades should not be taken.

Somehow, though, 1 to 2 percent morphed from a "threshold" to a "stop loss," I think that is incorrect. I think that when a triangle breaks, 1 to 2 percent can be considered as the threshold but that the stop loss is determined by the point of validity (POV). The POV in this case would be the other side of the triangle pattern. How could a triangle breakout through resistance still be valid if prices break down through the uptrend line support? It can't, and that's why for this set-up, the opposite side of the trade is the validity.

The other side of the triangle is not a percentage or pip consideration; it is support and resistance. If this POV represents 1 to 2 percent of your account size, then, sure, it's likely the trade presents too much risk. In other words, different trades will be appropriate for some accounts and not appropriate for others.

As to the second question, I don't have a problem with being long the EUR/USD and short the USD/CHF simultaneously. Each must have their own set-ups because merely being long on one does not justify being short the other in my opinion. And from the way the question was phrased, I would say you got that.

This also brings up a great point, harmony. I look for trades, when taking positions across different pairs, to have harmony. I don't want to hedge, and I don't want to take entries on the same time frame on different pairs that would require, for example, conflicting U.S. Dollar Index movement.

## STOP LOSS PLACEMENT

Stop loss placement is much more about using and understanding internal and external psychology, which is to say you must know where the herd will shift opinion and how you will react to it.

Trading can trigger the ego like any activity where your opinion and skill are tested. No one likes being wrong. We will put that feeling off, the feeling of admitting we are wrong, as much as we can. But what if being stopped out is a process of being right? What if the part of the trading plan

that shows the trade is no longer valid is also a way to pat yourself on the back?

Most traders do not follow their risk management plan (think stop loss placement) because they are not actively a part of the decision. Rather the placement is often dictated by a percent or pip or some such equally unengaging and random number. It's easy to ignore your stop loss when you are not actively part of the decision. Using a fixed level is not activity; you are not attached nor have you made analysis to the decision. These are easy mental traps to ignore. I think risk management in general is more psychological than it is technical or fundamental analysis. First of all, the decision to enter a trade is based upon some sort of analysis. Regardless of what yours is, there was a reason the trade was valid. The concept of validity is important because stop losses should not be based on a percent or dollar amount but rather where the trade is no longer valid.

I had a student who just absolutely could not, would not follow his stops. The problem was the stop simply meant nothing. If the level was a 20 pip stop, then it is usually pushed back to 25, or 30, or 45 pips. The number means nothing to validity so it is easy to manipulate. How about dollars? If a stop is based on a \$50, \$100, \$500 level, whatever your pain threshold allows, then it's easy to push it back as you rationalize why a \$100 loss is more or less the same as a \$125 loss and on and on it goes. Once we had worked the concept of validity into the risk management plan and made being stopped out a positive not a negative by redefining what it meant, the student no longer had this problem.

The 2 percent rule, if for no other reason, can help cap your loss if you accept that 2 percent is as much as you should risk. It's not what you should risk but rather the limit of what you can afford to risk. That assumes you know your risk before taking the trade and you make a decision about whether you can afford it or not. The validity argument stands up to these completely random fixed pips, percentages, and dollars because it injects some common sense into the process and engages you, the trader, in the decision making.

Validity means that there is a point at which your entry is no longer valid. In other words, staying in a trade should be measured by the level at which the breakout or trend or ceiling is still a reason to be in the trade. Why are you taking any trade? Certain conditions were right, certain criteria were met, and finally at some point, you saw the price you wanted to get, and that confirmed all your analysis. That is more or less the process, regardless of your strategy. So if all that work went into the entry, then how come we throw that out the window for some random risk management stop loss?

First of all, it stems from the fact that most traders don't consider validity a risk management strategy. It should be the only consideration! Why

would I hold on to a buy beyond the reason I first got into the trade? The reason traders don't use validity is they often don't even know what it is. How many traders know when their entry is no longer valid?

More and more should see that if stop losses are so habitually ignored that pain has become the most widely used strategy, then no wonder no one wants to follow their stop loss plan! Now what if your stop loss plan was a way to be right? What if you could have the confidence to turn common thinking on its head and say, *I know exactly why this trade is no longer working?* There is a "rightness" to taking a loss when it is part of your plan. There is a switch in thinking you're going to have to make. This switch is easy when you associate taking the loss at your predetermined validity point as control and being right. Is it a mental game? Sure. Call it what you want, but it is the only way to win at *losing*.

## TRIAGE

---

Decisions are made by asking the right questions. I am going to assume that most of us don't necessarily think about prioritizing trading opportunities in a systematic manner. Now I know this is not true for everyone, but humor me. I think that most beginning traders get so excited when they see a set-up on their charts that they fail to consider that (1) it may not be a suitable risk/reward for their account size and (2) there may be other set-ups that are occurring. One of the most intimidating aspects of trading for novices is simply getting through the chart before making a trading decision. This is really where most traders fail, and there is no other way to compare set-ups unless you know what all the available ones are. How can I get through all the time frames and pairs without missing a trade? What if it already triggered before I had time to analyze it? Here's the answer no one wants to hear. You're going to miss trades. Often! This is a 24-hour market. You're not going to be awake and at your desk for all of them. I would rather miss trades than take bad ones. Many times for new traders, since their analysis initially is slow, they end up taking the trade that is left. In other words, it's not a choice but a lack of options. You're going to end up with weak trades if you don't understand the importance of triage and analyzing all the potential opportunities available before entering a trade.

## TRADING TRUTHS

---

Over the years that I have been trading, observing others trade, and watching the markets, a few things have instinctively dawned on me. My guess

is that there are observations you've made too. More often than not, we don't follow our instincts to question the conventional wisdom of trading. It's handed down to us as fortune cookie wisdom: one liners with no instructions.

I think we give away our power and undermine our abilities because we think someone knows better or that the experts should be followed blindly. There's a fine line between thinking outside the box and trying ideas without merit or testing. At the same time, not all experts are truly experts, are they?

I'll give you an example, probably the most important one in my trading life. The idea of market cycles has been the single largest distinction I have made in my trading. The concept of market cycle isn't one I found or even invented. It was just a concept that I had simply read about. I had to find a way to determine what the cycles were, but there were no studies or techniques I could find that explained how to do this. So the experts had no answers for me. Too often this kind of frustration discourages us and we walk away—tail between our legs. Thinking outside the box—to me—means that having no answer is not acceptable. I don't mind saying, "I don't know," but I follow that up with "but I'll find out." I think most if not all the trading truths that are outlined below are to varying degrees fairly common. What's uncommon is that I've ventured outside the box to make the concepts actionable.

There's also a mindset that you're going to have to embrace: playing the odds. If most traders lose, then why follow what most traders do? Yet that seems to be what far too many traders do. We're after the 10 percent. The 10 percent is the minority. What do the few do that the many do not? Well, first they do not accept accepted trading wisdom at face value, especially when observations and practice show it doesn't necessarily work.

I could leave you with the following: "Be good, get good, or give up." But that would be selling both of us short. Let's talk about how to "get good." Let's start changing our own minds and being our own experts. Besides, no one knows what you think they know. And I guess I would have to include myself in that, too. Learn from everyone, but trust *yourself*.

## **Let the Market Cycle Dictate Entry Style**

The one thing I want to communicate to any trader I meet is this: Let the market direction tell you how to enter the trade. Now this is not a common thought or consideration, mainly because there aren't that many tools that traders can use to determine what the market cycle is. The Wave is what I use, and while I am biased, I do believe a combination of the Wave and market memory is the best way to identify the cycle of the market.



## **Don't Let a Winner Turn into a Loser: Ratchet Your Stops**

It's a trading truism that is seldom accompanied by any insight into *how* to actually accomplish this balancing act. There is a fine line between giving a trade the wiggle room it needs and moving beyond the reason you took the trade in the first place. The reason that most traders do not successfully find this balance is that there needs to be some definition of what trade validity is. Usually, the reason to stay in a trade and stop loss placement are based upon some arbitrary figure, typically a percentage or dollar amount or number of pips. A winner is easily defined as a point at which a profit target is reached, but the stop loss placement is far more important and must be defined by this and this alone. At what price is the reason to enter the trade no longer valid? This is risk management because a stop loss represents a risk-based exit. The two other exit types are break even and trailing. All three must be based upon support, resistance, and price levels.

## **Place Stop Orders at the Point of Validity or Logical Support/Resistance Level—Not Dollar Amounts, Not Percentages, Not Boredom**

The first point to establish here is that each trade has a point at which a trader sees the reason to enter a trade. The flip side of that is knowing when the reason to get in is no longer valid. This is often a foreign concept to many traders, because it is seldom discussed. Traders most commonly use dollars as more of a pain threshold to be reached before exiting a trade. Let's take a chart pattern entry to make the point here. A triangle is a chart pattern that triggers an entry when price pierces support or resistance. A break up through resistance triggers a buy, but can that buy still be valid if price trades lower through the support of the pattern? Of course not, and this is precisely the thinking behind using a point of validity to place stop losses. If you don't know the point of validity for an entry, then you must ask yourself why you entered the trade, the reason, and then look for where that reason would no longer be valid.

## **Never Treat a Trade Gone Bad as an Investment or Position Trade**

The thought of being wrong is not a comfortable one, and as human beings we will do and say anything to avoid it. This includes the conversations we have with ourselves when a trade is going against us. It's a feeling that only traders can share with one another: the self talk, the denial, the bargaining. The problem is that this behavior can finally manifest itself as a reason to

stay in a trade, even though the reason to do so is long gone. Traders will then redefine the trade, often turning it into a longer-term position trade or investment because the longer outlook buys them time but more accurately allows them to postpone what is the inevitable: admitting the trade is no longer valid and therefore that they were wrong. The fix is to treat validity as a decision that is as important as the entry. If the stop loss can be an active decision, the exit can be proactive, allowing a trader a feeling of control and therefore a certain “rightness” can be found even when the trade is a loser.

### **Go Long Because They Are Bullish Instead of Being Bullish Because They Are Long (Think about It!)**

There is a mental trap in analysis because the ego is involved in our decision making. Analysis is personal; it's our work, our skill, and opinion on the line when we put in a trade. As in an individual sport, there is a certain confidence we must have in ourselves. In order to protect ourselves or most accurately our sense of being correct, we will look for reasons that back up our opinion. This is where we look to darn near do anything to back up our thinking rather than reassess. The only reason to buy is bullish analysis. The trap is that our position in the market will create bias that causes us to see what we want to see.

### **“Oh Crap” Is Never a Reason to Get In or Out of a Trade**

The fact that order entry platforms look more and more like Las Vegas slot machines with their flashing prices and pretty color points is what brokers know: There is a certain impulse to trade when sitting in front of your computer. The impulse to trade comes from when trading becomes more reactive rather than the execution of a well-laid plan. The culprit most often is the “buy” or “sell” button, the market order, because this is the order entry that can encourage reactive trade entries and exits. They are the “now” button. Very few if any trades should be executed this way. If you find yourself hitting the market order button on a regular basis, then something is being missed in your trading set-ups. or you likely don't have a trade set-up at all. The “oh crap” entry or exit is the knee-jerk reaction that we want to avoid.

### **Enter Trades Based on Price Action**

Price is only a level playing field. Trading news doesn't work consistently on a short-term intraday basis. Price is the measuring stick. Price creates support, resistance, chart patterns, highs, lows, and market cycles. News

and fundamentals are reflected in price, not the other way around. The process of discounting assures this. Remember that price measures the psychology of the market. Fear and greed make the market move, and price is the best way to measure this.

### **Top and Bottom Picking Is Only about Ego**

Discussing trading and trading psychology without talking ego is impossible. Ego drives most of our bad decisions in trading. Ego is what drives us to want to pick the top of a market or the bottom. It's the thrill of being right. Picking tops and bottoms in many ways is also encouraged by what is on television and by analysts because this is the glory trade: Who doesn't want to be the one who called a top or bottom in a market? There are set-ups that can help us identify tops and bottoms. Dow 1-2-3s and double bottoms/tops are common chart patterns that can help identify these turning points. The main reason any of us looks for a top in an uptrend or a low in a downtrend is that we are not already in the trend. The only traders looking for tops and bottoms are the same traders that are not already riding the trend. This also makes top and bottom picking the ultimate revenge trade.

### **All Indicators Are Based on Price and Therefore There's No Such Thing as a Leading Indicator**

Most people love the idea of telling the future. Traders are no different. The idea that we can find that one indicator or setting that can "tell the future" is too tempting a fairy tale to stop believing in. First, let's consider that leading is simply the wrong word, because more accurately the word should be projecting. Think about indicators as projecting where price could go. The idea that an indicator that needs price in order to be plotted can be leading price as well is not logical and wrong. Nothing leads price.

### **No Single Entry Strategy Will Work for All Market Cycles**

The idea that one strategy will allow us to trade all market moves is one that we must admit is impossible. The market can trend, move in a range, and reverse; so we need a strategy for each one at a minimum. We can have more than one for each cycle but in the end, whatever strategies you now have were designed to capitalize on certain price movement. Often this is the part of the explanation that seems to be left out. This results in traders applying entry strategies in a random manner or waiting for a set-up to appear regardless of whether it is happening in the correct market environment.

## CHAPTER 13

# Embracing Automation



**Don't get buried in analysis.**

2007 "Fxstreet.com. The Forex Market." All Rights Reserved.

Since I am writing about Forex in Five, there is a chance that people will insinuate that forex trading or any trading for that matter can be or is a part-time endeavor. That's not true. "Full-time trading" should mean that it replaces the income that you would have from a full-time job. "Full-time trading," though, has somehow been turned into 12- to 16-hour pursuits of insomnia driven, get-up-in-the-middle-of-the-night trading.

So let's agree that "full-time trading" is about having the type of income you would have from a full-time job. If your bills are paid through your

trading activities, you could in fact be a full-time trader regardless of the time spent in front of your computer screen.

I bring this up because at some point you will wander into the forest of the World Wide Web and come across forums and chat rooms all touting a mechanical system that works. I'm sure some of it does for some people and I'm certain most of it doesn't work for most people. Think about this: If you had a system that was 100% mechanical (think "set it and forget it") and generated consistent profits, would you share it? If you said "yes" you are a liar. If it worked you would very quietly make that profit for as long as it did. Period. And that's precisely what most traders that you will never hear of that have a mechanical system do. I am referring to 100% mechanical systems. I will say the same of forex analysts. People who are hired as analysts by and large do not trade. They look good in front of a camera and have some nice university pedigree. Some and it's rare, do both, they trade and talk about trading. Their writing is focused on the "right side of the chart." That is how they position themselves for what is going to happen next ... not a report about what has happened!

The problem with most systems is that once they are sold, once they have gone public you can count on two things: (1) The days are numbered for profitable trade results, or (2) the system does not or no longer works. It reminds me of a system that is hugely popular right now. I won't name it because honestly it doesn't matter, and even if you pick up this book five years from when it is published, another 10 hot systems will have come and gone, and the story is generally the same. But I want to use a real example here because I don't want you to think I am simply just dismissing all systems. That would be stupid as many work, but you will never be able to buy it and you likely will never even know about it in the first place. The best and pretty much the only mechanical systems that work are owned and operated by hedge funds.

This system I am referring to has the unique distinction of being one that worked. Notice I use the past tense because—and here's where it gets interesting—the creators of the system decided to sell it. By doing so they strangled the golden goose. This system was not exactly a system as much as it was a "gimmick" for lack of a better word.

Let me tell you about the Small Order Execution System (SOES) bandits. Maybe you've heard of them? They were the early adaptors of direct order execution and electronic communication networks in 1994–1995. This is when the Internet was still new, and entering your stock trades was beginning to bypass the traditional phone call to your broker and instead was being routed through SOES. Had direct order entry never taken off as it has now with the proliferation of online brokerages, these SOES bandits, as long as they were small in number, would probably have kept right on doing what they were doing.

What they were doing was taking advantage of when the “Big Boys” were letting their guard down and updating the bid and ask on stocks. These SOES bandits with their new access into the markets and transparency that came with directing your own order flow would capitalize on difference in price from one brokerage to the other and basically scalp. It worked, too!

We knew our days were numbered though. As soon as the Big Boys realized what the SOES bandits were doing and that it cost them money while the bandits multiplied like bunnies, the party was over. There was nothing illegal with what the bandits were doing. With transparency to see the late updating of price and the ability to route their orders to this lagging bid or ask price they were free to do this. In fact, the very growth of the number of bandits is what woke the Big Boys (the market makers) up. The market makers never had worried about this level of transparency and access before—until the SOES bandits. Fast forward to the forex and to the system that actually worked.

This system, as I said, reminds me of the bandits. The bandits were not taking trades on trends or any kind of price action. They were taking advantage of a particular event (late bid/ask updates), and soon as the market makers wised up, the game was over. It was a gimmick in this regard. Not sustainable. This popular forex system is exactly the same. It takes advantage of a widening of bank rates and the fact that many brokerages will, for the sake of keeping a steady three to five pips spread across the majors, not adjust for the widening bank spread during daily reconciliation. The story is going to end the same way. If the creators kept quiet and simply went about capitalizing on this discovery they had turned into a system, I would never be talking about it because I would never know! Instead they sold the system, just as many SOES bandits began writing books and giving seminars. Once everyone knows, the game was over.

If you have a system that you are playing with in the hopes that it is your very own ATM machine, enjoy it while it lasts. If you bought it from a website and it works, count your lucky stars and count the days before it stops working. I have been at this game far too long and seen every type of system and gimmick come and go. My trading is discretionary, which is to say I trade by interpreting what I see in price action. Interpretation is subjective, and no matter how many people I teach it is not likely to be systematized.

No matter how tempted you are to let a system do the work for you, use some common sense. Trading is not *set it and forget it*. Even systems traders have to tweak their systems from time to time.

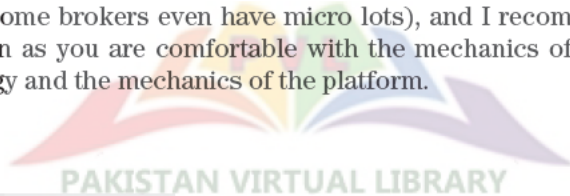
Automating your trading analysis is not the same as systematizing it. Automation is what I do. I try and automate as much of my homework as possible, and you should too. Here’s how to start, and it begins with your charting.



## CHARTING TOOLS

You need to find low-cost charting tools, especially as a beginner. This is not because I think you should begin your trading career as a miser, but I would like to see you put your hard-earned dollars where they will do the most good. The first consideration is funding your account. That will be your largest cost. There are a number of tools I use that I have found are continually great and low-cost assets to my trading. While I do use eSignal, it may not be the best place to start if you are a brand-new trader. I am a big fan of the Metatrader 4 (MT4) platform since it is free and can accept automated plug-ins for technical and charting tools. You can try eSignal for 30 days free at [eSignal.com](http://eSignal.com). My personal rep there is Scott Wilks, and you can reach him at 800-322-1819. You can download MT4 through a number of brokerages or directly from [metaquotes.net](http://metaquotes.net). I also make my GRaB plug in for MT4 available free at my blog.

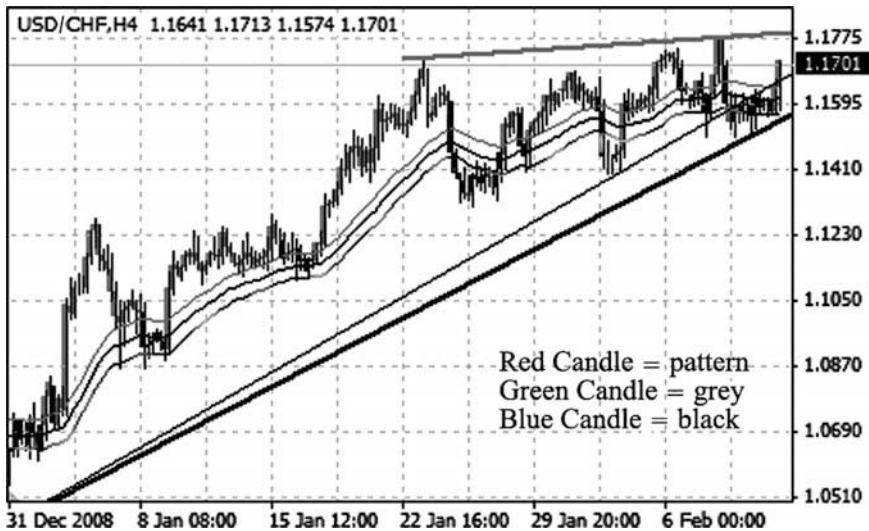
MT4 is free, and as you begin trading it is a great way to learn charting and order entry through the demo version. Eventually you can graduate to mini lots (some brokers even have micro lots), and I recommend you do that as soon as you are comfortable with the mechanics of your trading methodology and the mechanics of the platform.



## PROFIT TARGETS

I am going to share with you one of the best, low-cost tools that will help you automate much of your homework. It's called Autochartist. With Autochartist and the MT4 platform you'll see with a few free plug-ins and the entry styles you have already learned earlier in the book that you can put trades together with ease. We've already discussed Lazy Days Lines, and they are great, but there are other ways to find decision levels on your chart. I am going to explain an effective way to use short-term profit targets (aka forecast areas) to set-up longer-term moves.

In this example we'll look at static levels (ceilings) and how to confirm these price points with a shorter-term chart follow-through and profit target. Often you see what I call a "one thing leads to another" play where short-term charts follow-through leads into a new position in the same pair but on another time frame. In the example below, the question to be asked is: Will the U.S. dollar continue to strengthen? That's the answer needed to determine whether the USD/CHF will find resistance once again at the soft double top formed at 1.1715 and 1.1740 (see Figure 13.1).



**FIGURE 13.1** USD/CHF Four Hour Chart with GRaB MT4 Plug-In

The older uptrend line from the asymmetrical triangle has been updated with a new uptrend line created by initial weakness after the pattern formed. Same pattern, new support, but it's the strength of the resistance we're interested in here.

The market cycle is arguably even better now as prices have continued to consolidate and with U.S. Dollar Index strength, the franc is falling against the dollar. A ceiling in the dollar will be the key to whether traders will once again shift to bears in the 1.1715 to 1.1740 price range. This level is further helped by the 1.1750 psychological level, which will be near-term resistance.

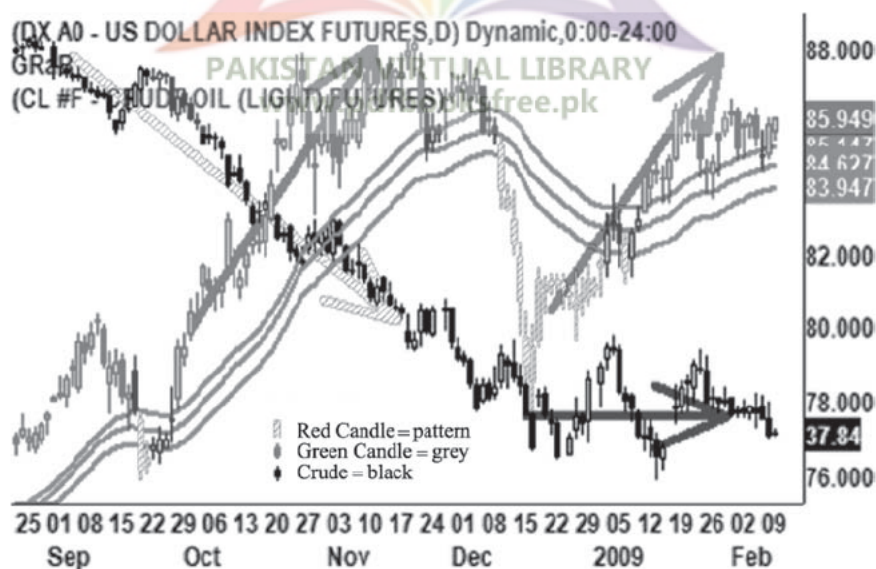
Zooming into the 60-minute time frame, there is a rising wedge that has formed and is following through in the swissy rally. The pattern itself and the breakout confirm what we already know: the dollar is gaining on the franc. It's the forecast region here that can help with the 240 chart pattern set-up (see Figure 13.2). Rising wedge pattern breakouts with forecast area are highlighted.

The forecast region of the rising wedge pattern is between 1.1720 and 1.1740. This is where a near-term ceiling is likely to form according to the expected follow-through. This equates to resistance, and this resistance falls in line with the soft double top on the 240-minute time frame.

How about another example of this "one thing leads to another" set-up at work? In Figure 13.3, crude oil broke the \$40/barrel support it has been bouncing along since January 20. Under a normal or typical market

**FIGURE 13.2** USD/CHF 60-Minute Time Frame

Images © Autochartist.

**FIGURE 13.3** Crude Oil and U.S. Dollar Index

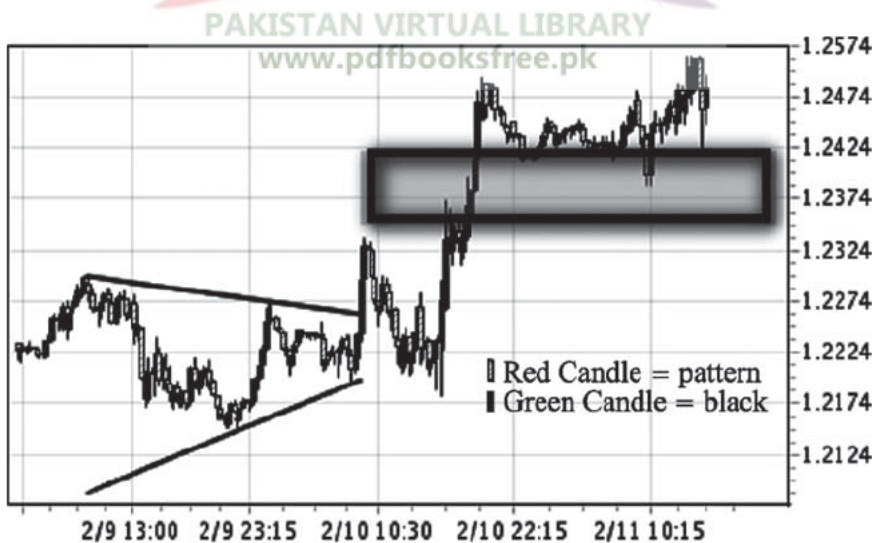
© eSignal, 2009.

environment, the U.S. Dollar Index and crude oil futures would move in an inverse correlation. However, this is anything but a normal market, and so we see the correlation between the U.S. dollar and crude oil not syncing as it usually would. This is an important note for USD/CAD traders.

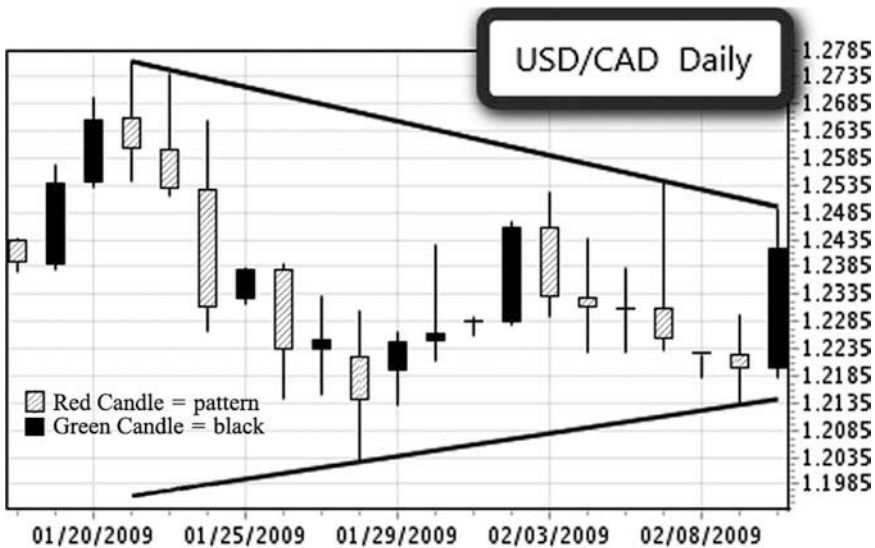
This chart shows the past correlation that the dollar and crude had traded in and the current state of that correlation as the crude oil market is flattening and the dollar continues higher in the safe haven play. Realize that the dollar is traveling in an upward direction that would point to a neutral to weak crude oil market cycle.

There are a number of pairs that are affected by crude oil; the commodity currency USD/CAD is the first on that list. The idea of a commodity currency or “comm doll” can be slightly misleading when you consider that most currency pairs are either directly or indirectly affected by markets such as the dollar index, crude oil, gold, commodity index, Dow, and Fed Funds futures.

The short-term, 15-minute chart breakout of the USD/CAD reflects Tuesday’s break below \$40/barrel in the front month of crude oil. The set-up to be discussed extends past the chart pattern alert itself and focuses on the forecast region that the PRS program includes on “complete patterns,” that is, patterns that have broken out of the pattern’s boundary (see Figure 13.4).



**FIGURE 13.4** USD/CAD 15-Minute Chart  
Images © Autochartist.



**FIGURE 13.5** USD/CAD Daily  
Images © Autochartist.

Upon breakout the “complete patterns” section of Autochartist will plot a shaded area on the chart indicating what is called a “forecast” or a likely area of resistance in a breakout (conversely this would be a likely area of support in a breakdown). There are ways to use this forecast area plotted by the PRS to aid in determining where the pair will travel to next. In this case, the current support and stall just above the forecast region would suggest further strength on the daily chart; however, a break below this support region would suggest weakness (see Figure 13.5).

The Canadian dollar will likely continue to weaken against the U.S. dollar if 40.00 becomes resistance in crude and if the dollar index trades higher towards 86.00. Together, if the current direction persists, these two markets could nudge the USD/CAD through the downtrend resistance of the triangle pattern on the daily chart. Add to that the support of forecast region identified by PRS and the breakout has the buying support it would need to potentially push the USD/CAD higher.

## FIFTEEN-MINUTE SET-UPS

When the market is especially volatile and you need a low-risk, short-term entry, the 15- and 30-minute charts will be the best place to look. While you



don't want to favor certain time frames with no reason, a market that is not following through on longer time frames (such as the case when the U.S. Dollar Index consolidated) is a good time to adopt a shorter-term view of the markets. Short-term chart patterns on the 15-minute chart can be key to early and sometimes more aggressive entries.

I usually don't make a habit of choosing one time frame over another. The set-up itself should be the primary consideration, not the time frame. Often, though, if the market is range-bound on the larger time frames or if there is a trend that I want to find a more aggressive correction on, I will often focus on the 15-minute time frame.

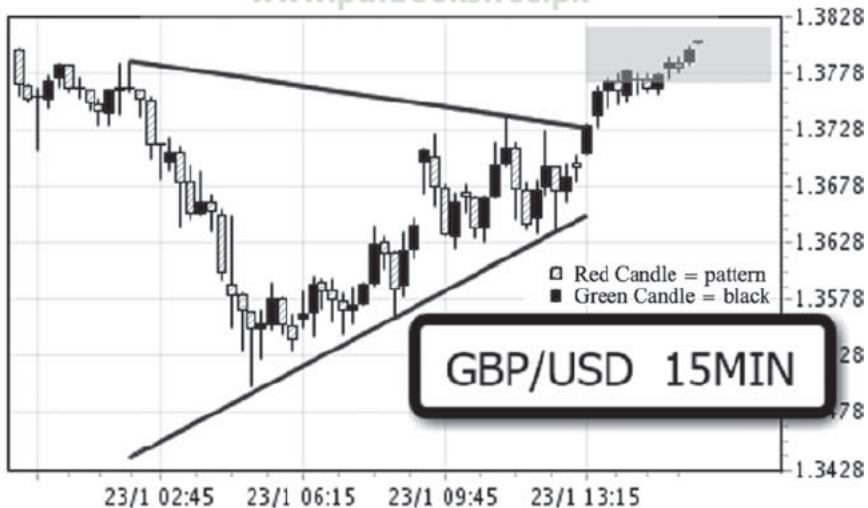
And that's not to say that momentum set-ups aren't effective on the 15-minute; they are! In fact when the 30- or 60-minute doesn't give me a consolidation/congestion cycles, it's the 15-minute that will be the time frame that is the only way to enter the breakout/breakdown.

I usually feel that 15-minute charts are aggressive in momentum and swing entries because they are the alerts that will show up first ... and that's both the strength and weakness of the short term. You may be getting in with the only opportunity, or you may be getting in too soon or too aggressively.

The key is to know this!

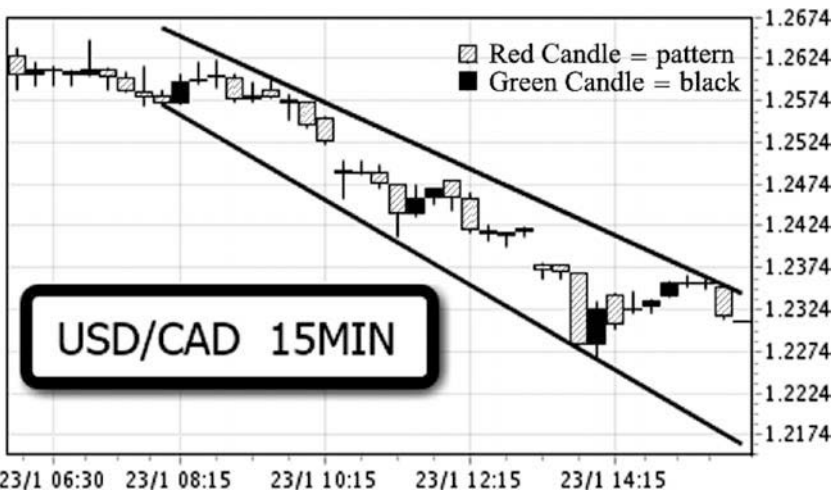
Here are some great 15-minute set-ups from Autochartist.

Figure 13.6 is a set-up that has already followed through, but the reason I think it will be one to watch is because it's trading inside the forecast



**FIGURE 13.6** GBP/USD 15-Minute  
Images © Autochartist.





**FIGURE 13.7** USD/CAD 15-Minute  
Images © Autochartist.

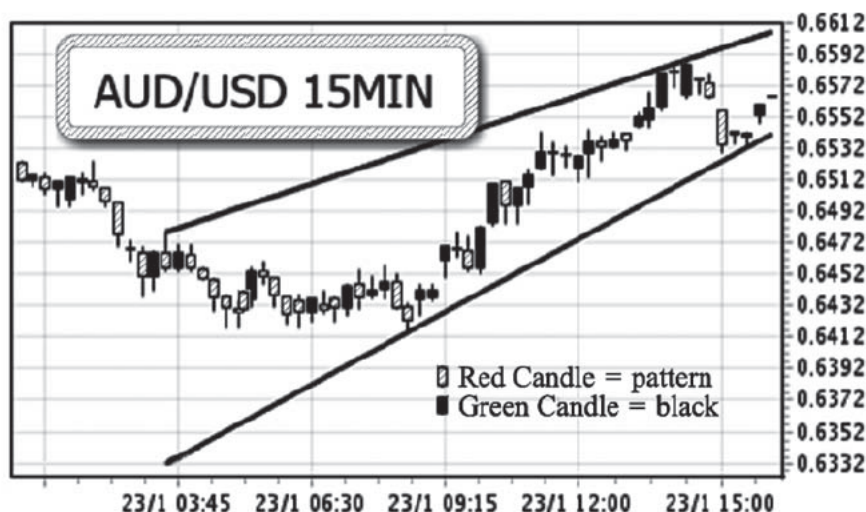
region, which will be resistance. If this time frame begins to pull back, there could be some corrective opportunities on the 30 or 60.

I love this look because in any trending set-up there are three possible entries and two that I look for in particular. First, and this should be the first consideration, is the trend follow. Look for weakness and selling pressure at the downtrend line resistance line (green). The other consideration will be a breakout through the green line as a trend reversal as shown in Figure 13.7.

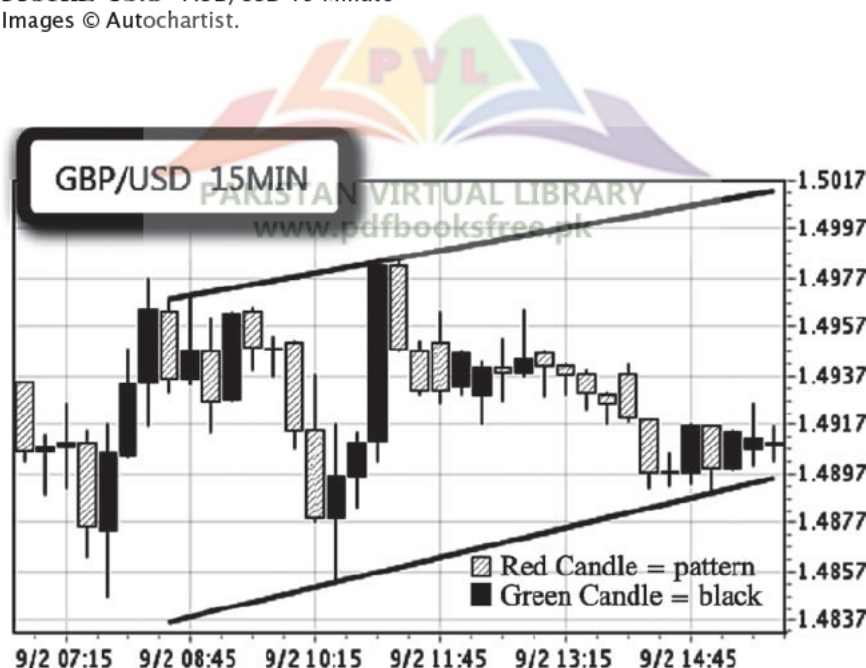
As Figure 13.8 shows, the aussie is setting-up a similar set-up to the canada. Instead it's an uptrend, and the support line (blue) is where buying support would be expected to step in.

The set-up in Figures 13.9 and 13.10 is a short-term (15 min) chart pattern. Bear flags are upward angling, short channels. The trigger for the short occurs when the uptrend line support is broken. These patterns can set-up in both an accumulation or distribution cycle; this is occurring in the distribution. The trigger for a flag is always in the opposite direction of the angle. Bear flags angle up, while bull flags angle down.

In Figures 13.11 and 13.12 we pick up from where the 15-minute bear flag formation has followed through, but is there another set-up now that the trend has established itself? The downtrend that has initiated from the breakdown has formed a four to six o'clock mark down cycle and an opportunity to set-up swing shorts within a down channel.



**FIGURE 13.8** AUD/USD 15-Minute  
Images © Autochartist.



**FIGURE 13.9** GBP/USD 15-Minute  
Images © Autochartist.

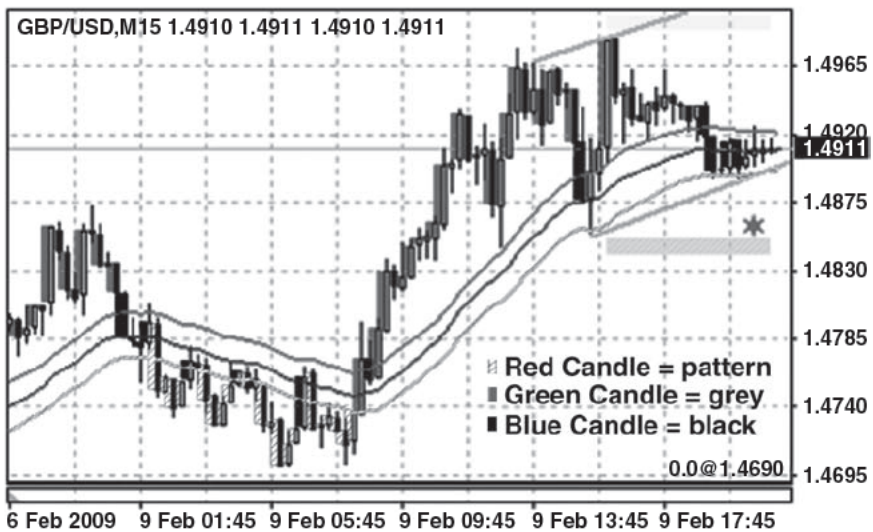


FIGURE 13.10 GBP/USD M15

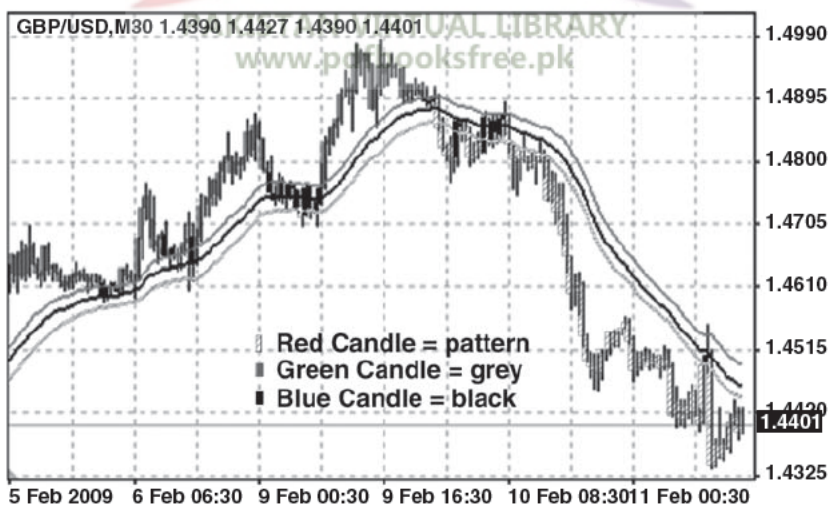
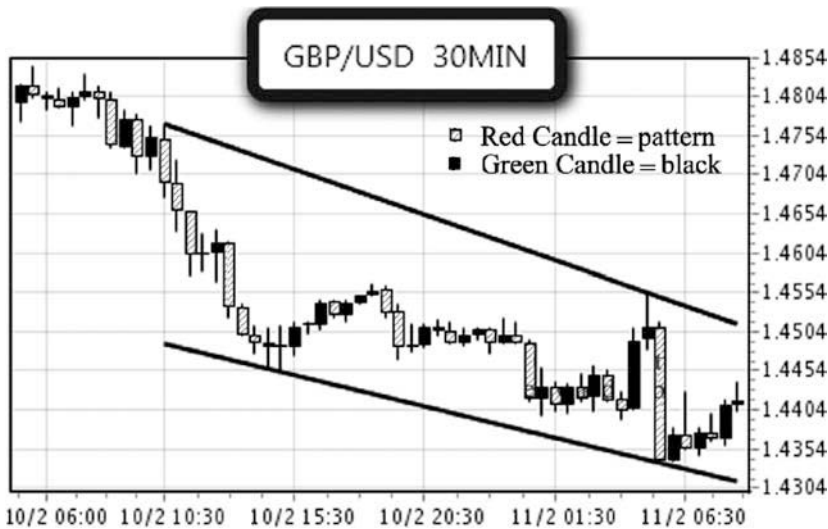


FIGURE 13.11 GBP/USD 30-Minute



**FIGURE 13.12** GBP/USD 30-Minute  
Images © Autochartist.

The downtrend is best capitalized on shorter-term, intraday charts right now as the longer-term trend (daily chart) is sideways. Follow-through in this environment of uncertainty is difficult to come by on longer-term intraday (180- or 240-minute) charts.

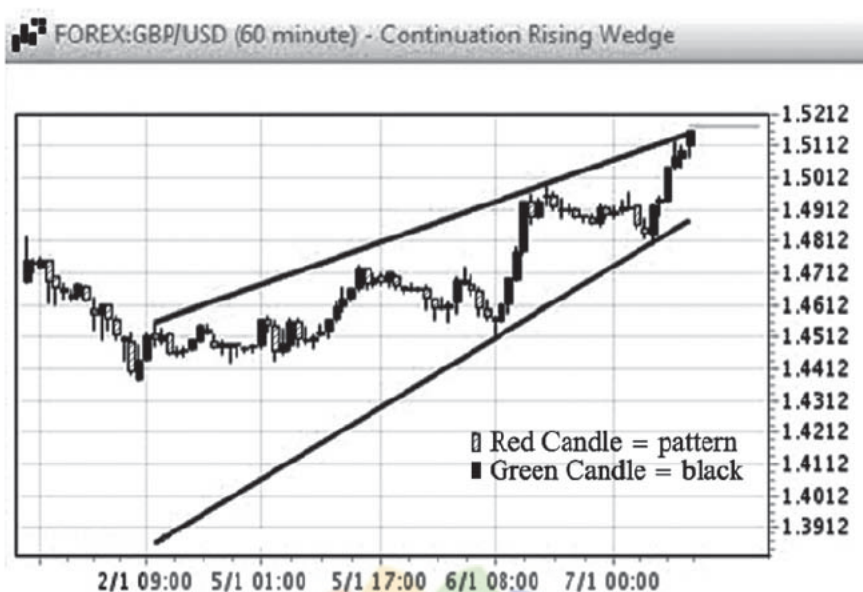
Look for short triggers between 4435 and 4450 on the 30-minute chart. The downtrend will be intact on this time frame until the cycle flattens (keep an eye on the Wave) or prices find their way north of 4500.

Playing trending patterns is the best way to play trends, but what do you do with the trend reverses? How do you know when to keep following the trend? Those same trending patterns can help you set-up reversals just as effectively as they helped you set-up swing trades. In the following example, I'll take the GBP/USD on the 60-minute time frame and show you two scenarios of actual trades (see Figures 13.13 and 13.14). First is the rising wedge continuation play.

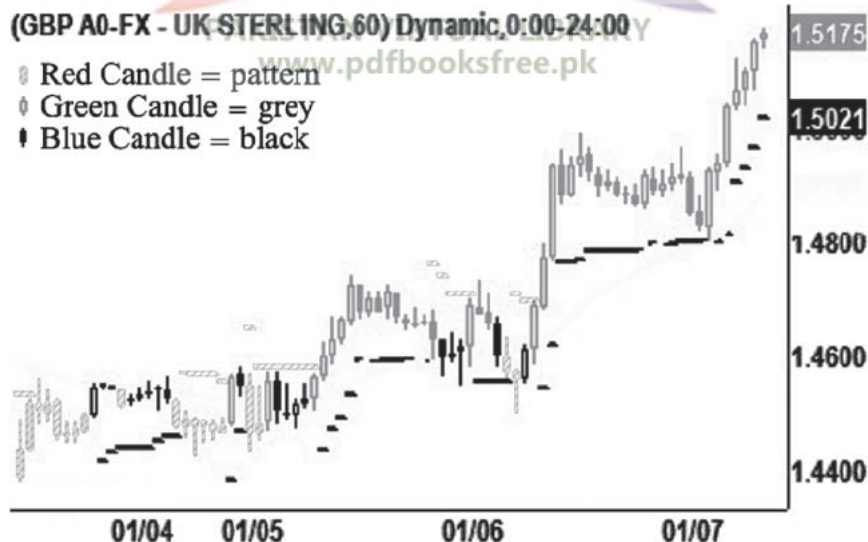
The cable on the 60-minute chart is climbing within the rising wedge pattern on the intraday uptrend—exactly the type of play I'm looking for when I want to trend follow.

The green candles indicate that prices are trading above the Wave, and, of course, you wouldn't need that visual cue in this situation because the higher lows (support) are obvious.

The play here is to wait for the pullback and trigger a long with that. A pullback to where? The support of the top line of the Wave would be on spot, but the problem with that is that it is far, far south of where prices

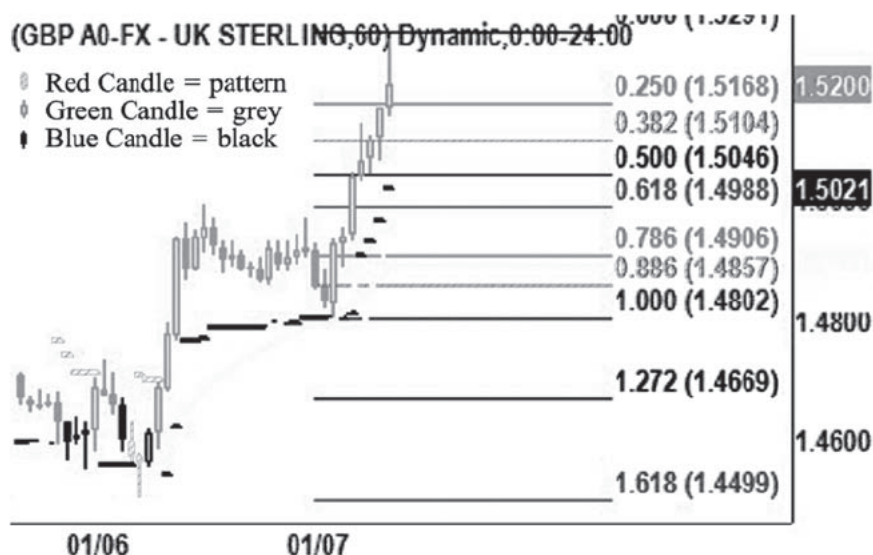


**FIGURE 13.13** GBP/USD 60-Minute  
Images © Autochartist.

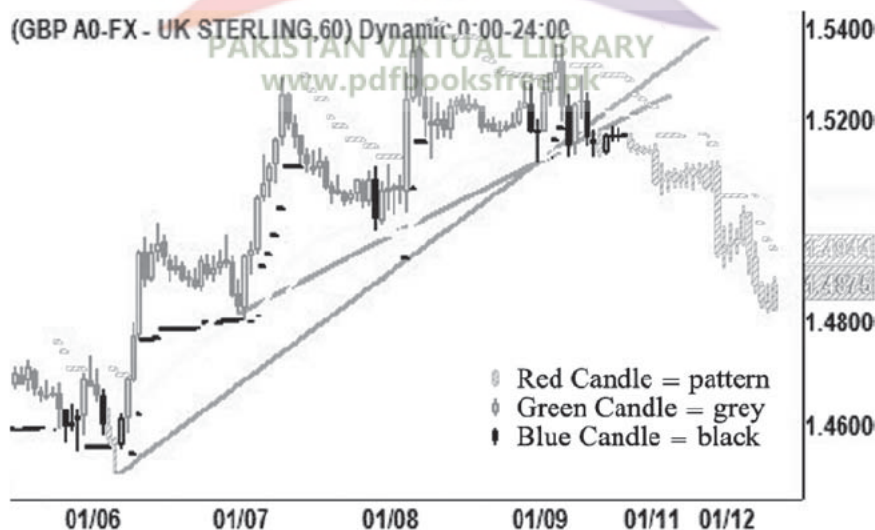


**FIGURE 13.14** GBP/UK Sterling  
© eSignal, 2008.





**FIGURE 13.15** GBP/UK Sterling  
© eSignal, 2008.



**FIGURE 13.16** GBP/UK Sterling  
© eSignal, 2008.



are now. The other option is to use the last major move and pull a Fibo off it (see Figure 13.15).

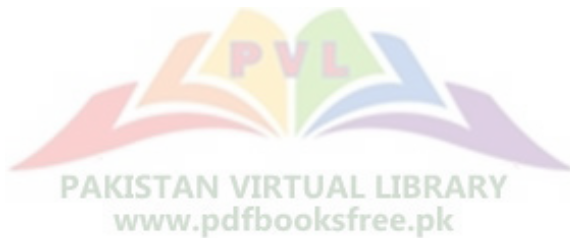
I'm not usually a fan of a .25 correction for an entry (too shallow) so the .382 is what I'd be watching *plus* it's got the support of the 1.5100 "00" behind it, which is always good.

But what happens when the trend weakens and reverses; how do we know to get out of trend follow thinking and set-up a reversal? The uptrend lines I drew here were one part manual uptrend line and one part rising wedge support line. See Figure 13.16.

As you can see with the cable selling off sharply through the support of the rising wedge, you must be asking, *Now what?*

The two uptrend lines I have drawn are representative of the reversal and sell-off, and they represent the reversal play from the breakdown of the wedge pattern.

Remember, every trending pattern can be played as either trend follow or trend reversal. In this case there was opportunity for both.



## CHAPTER 14

# Raghee Recommends

**T**he Internet is a big place, and finding the sites that will not distract you is a constant challenge. I am going to list some of my favorite sites in no particular order and tell you why and when I use them. Mobile trading is all about the equipment that will let you escape the office and the sites that will keep you from being out of touch.

This works into my mobile lifestyle because I feel like a self-contained unit when I have my MacBook and an Internet connection. Now let me add that if you are going to run out and get a netbook, I caution you because they are good for little more than e-mails and surfing. If you are going to run out and get a MacBook, remember that trader-friendly software is far and few between. You will need to get software like VM Fusion to run Windows and your charting platform. I try to get my trading entries in the market in the morning when I am at my home office and then I am free to head out and manage positions with my MacBook and iPhone on the road. I'm not trying to encourage anyone to trade from a Mac as much as I love mine. I'll be candid, I got a MacBook because I bought one as a gift for one of my best friends and loved it so much that I purchased one for myself as well. You're better off (as of now) on Windows. My home office desktop is a Dell XPS, which runs Vista on four vertical-set monitors.

The sites that I have access to, they make a huge impact on my gauge of the market. The first site I visit each morning is Forex Factory ([forexfactory.com](http://forexfactory.com)) for their economic calendar, which is the best on the Internet. I look at the timing and projected impact of the reports across multiple financial centers. One of the more attractive features to the calendar at this site is that there are excellent descriptions of the reports as well as a

historical result chart that allows you to see past results, pick up on trends, and see the month-to-month impact.

I also like to check out Bloomberg's currencies section for recent news analysis of the world's currency pairs. There are concise articles about everything from the euro to the yuan, and for someone like me who is not going to set-up trades with news or data, having this information makes sure that I am not up against some soft or fundamentally driven tsunami. So if Forex Factory helps cue me to data releases and expected impact, Bloomberg gives me a bigger picture of stories as currencies trade through the financial centers.

I also have to mention that I love reading The Kirk Report ([thekirkreport.com](http://thekirkreport.com)). Even though it is a stock trading-driven site, the links that Charles Kirk puts together by scouring the Internet are among the most insightful, entertaining, and thoughtful collection of links you will find. Check it out daily, it will be worth your while. I'm a big Kirk Report fan!

I will also recommend Quote.com, which is an eSignal site that will give you access to charts and quotes. Now I run eSignal so I will use that. I pay for access to most futures exchanges, but I know not everyone wants to have that expense each month. I have also been using Pro Real Time ([pro-realtime.com](http://pro-realtime.com)) recently, and while I am still getting to know the software, their browser-based charting allows me to run charts on the Mac side of my MacBook rather than running Windows in order to access eSignal or MT4. Since I also have the Forex on the Go app, I can get live charts, quotes, and access my MT4 trading account right through my iPhone.

There are sites that I recommend to traders especially if they are in the beginning stages of their forex journey. The first and one of my favorites is Baby Pips ([babypips.com](http://babypips.com)). Baby Pips is exactly as the name suggests; a haven for new traders. You can learn all the basics about forex (free!) at the School of Pipsology and read some excellent blogs (I'm Queen Cleopiptra there). The good folks of Baby Pips have also developed a sort of Facebook for forex traders called Meet Pips ([meetpips.com](http://meetpips.com)), and if you think that trading isn't lonely and isolating at times, think again. Community websites continue to grow in popularity.

Another site that is a terrific resource is Daily Motion ([dailymotion.com/e22tradesoftware](http://dailymotion.com/e22tradesoftware)). It's a video site like You Tube but can host much longer videos. I use this site to upload educational videos, and there are dozens of lessons available for replay. You will find shorter lessons as well as full 30-minute plus webinar playbacks. It's a collection of webinars you can watch right on your desktop! I am also proud of the fact that my content there has been authorized as "Official Content" by Daily Motion.

Another site with a very unique tool is Autochartist ([autochartist.com](http://autochartist.com)). The team over at Autochartist has developed some price movement tools; the one they allow free access to is the PowerStats Basic. This tool allows

you to see the pip movement in individual pairs. You can see the average price movement by day of week, by hour of day, and many other interesting categories. What this site will do is give you a crash course in the personality of the pair you are trading. This has volatility and risk implications as we have discussed earlier in the Power Stats discussion.

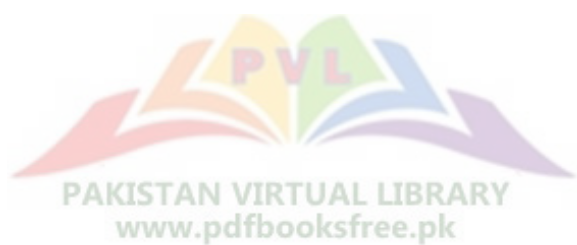
For those of you who are interested in forex options, I would highly recommend the ISE website ([ise.com/fx](http://ise.com/fx)). The options education that is there along with the charts, quotes, and historical volatility information is a wonderful resource for those of you looking to add forex options to your overall approach. I also conduct webinars for the ISE on forex options trading a few times a year, and the archived webinars are available at the ISE website for those of you who are looking for a solid introduction to how I trade options.

I don't want to fail to mention some sites that I write for such as Forex Trader Daily ([forextraderdaily.com](http://forextraderdaily.com)), FXStreet ([fxstreet.com](http://fxstreet.com)), Trading Markets ([tradingmarkets.com](http://tradingmarkets.com)), and Pattern Radar ([patternradar.com](http://patternradar.com)). I contribute analysis, videos, and lessons at these sites. I update the list of my favorite sites over at my personal blog, [ragheehorner.com](http://ragheehorner.com).

Here are a few sites that while not trading-related I find are a tremendous help to me personally. Being a home-based trader comes with its own challenges. For one, the refrigerator is too close and convenient for my liking... and the pool outside my office here calls to me with the sweetest song on sunny days, which we're known to have more than a few down here in South Florida.

I am a big fan of the site Zen Habits for the lessons on simplicity ([zenhabits.net](http://zenhabits.net)). Read it. I imagine you will either like it or not, but it is one of the best written and most popular blogs on the Net, and I hope you'll check it out and see if some of the lessons in decluttering your life will work for you. I also would recommend Lifehacker ([lifehacker.com](http://lifehacker.com)) for anyone working from home. I have found more than a few good ideas and software programs that were reviewed at the site. Gina Trapani who started Lifehacker also has a blog of her own which I recommend as it is a great extension with more a personal view ([smarterware.org](http://smarterware.org)). I also recommend The Freakonomics blog, and if you haven't read the book, go buy it. It's a great read (<http://freakonomics.blogs.nytimes.com>).

You have to find constructive distractions as a home-based entrepreneur, and that's what you are when you are a home-based trader. If you cannot effectively distract yourself from the market, then you are likely to overtrade and overtweak your trades. My distractions have saved me from too many bad trades to even recall and saved my good ones from the natural inclination to micromanage when left with nothing better to do.



## Final Thoughts

If you haven't already noticed, I'm not one to recommend canned set-ups, and by that I mean those trading set-ups that you simply look for in a certain candle or pattern or indicator to do the same thing over and over again. Set-ups are rarely that obedient. Analysis and set-ups can never be done correctly without first considering the underlying direction of the market. This is precisely why the steps of the set-ups were explained within the market cycle and why you should be looking for them to set-up in. The idea that any set-up can be traded simply when it occurs is incorrect.

There is no way a book full of canned set-ups, and I call them canned because of their generic application to the market, can make you a successful trader. The aspect that most traders fail to examine is the application of a strategy. There is little discussion of when to use particular strategies as the emphasis is simply on recognizing them. I can tell you that a triangle can occur almost anywhere on a chart but that the triangle that you should trade must occur in a sideways market cycle. There's a big difference between finding a set-up and setting up the market cycle.

Most traders experience haphazard results exactly for this reason. The consideration of what the market is doing must dictate how to trade it. I think that traders are not necessarily to blame here; it's the educators and writers and analysts that are really at fault, because the idea of applying the right tool to the right job is often lost or ignored in the message. Frankly, I think this is because there was no real-time tool that was available to make decisions about market cycles before. Now you have one, the Wave. We start all analysis with the Wave. This will keep you focused on the right and most effective chart patterns, indicators, and set-ups, and it will save you time.

Time, trading time in particular, is another aspect that the Forex in Five trader uses to her advantage. Understanding the role of individual financial centers is absolutely vital to knowing when and when not to trade! We have spent plenty of time on this topic, and I recommend that you review the discussion of Power Stats until you have a feel for the ebb and flow



of the market. This means you are acutely aware of who is awake, market overlaps, and economic data releases.

Forex in Five traders know that sitting down to trade or enter trades is not a matter of convenience but actually a matter of effectiveness. You can fit the forex into your schedule, but you must always be aware of time as it will present different levels of participation and volatility. Most forex traders find that they are too active in the Asian session or stay up for the Frankfurt and London session without considering pip movement at each hour of the day. Trading at those times is not necessarily wrong, but there are factors like follow-through and those offbeat hours themselves to be aware of!

The mistakes that most traders make can be summed up in the two points we have just discussed: market cycles and time. How and when you trade is just as important as the strategy or pair. In fact, if you came away with nothing else but those two points, you are well ahead of the game! If you apply just these two ideas to whatever your current strategy is, you will increase the effectiveness of your entries in a way that nothing else can.

Forex in Five is also about embracing those strategies that are easily repeatable or can be automated. I am not referring to system trading but rather automating manual processes that you will continue to filter and confirm with your discretion. For example, I am fond of software that automates chart patterns. It does not take the place of my decision making but rather takes the time-consuming task of finding the patterns for me. If you are scanning multiple pairs and time frames, this is helpful. Remember that canned strategies fail to produce consistent results because they typically do not consider the market environment, so you can repeat the steps, but you may not be doing so in the correct market cycle. Also, you know that these set-ups have variance since they will not always look alike. So once again you must understand the thinking behind the strategy. It's never as simple as a matter of following step one, step two, step three! This is canned and doesn't work over the long term, but I think you probably already know that. Systems are great if the system is used in the correct market cycle. Discretion does not mean that you don't have a methodology, but rather it means that you apply it under the correct set of circumstances.

Forex in Five also means that psychology comes first, second, and third, and any place after that. And I don't mean just the inner, touchy-feely, "Why can't I be a good trader?" psychology, which I frankly believe there is too much made of. The first psychology to consider is what the market is reflecting in price. Price and price patterns will give you insight into this. Realize that inner psychology is the culmination of comprehension and confirmation. It's uncertainty or the lack of confidence that makes traders either overtrade or undertrade (yes, there is such a thing as undertrading). Confidence should only come with the knowledge that you can

recognize the set-up and confirm that what you are recognizing is working! If you can find a set-up but it does not yield successful results, you will not have trust in it and will constantly be searching for something else. And while this may seem obvious, if you don't understand what you are looking for, how can you possibly have confidence in it? The best traders in the world, and I have been lucky enough to meet many, keep their trading remarkably simple. The more complex I see a trader make his craft the less successful I know he is.

Anything more about inner psychology is unnecessary. And I am not saying this out of some misguided sense of self. I know because I have been both a confident and unconfident trader and know that this battle to hold on to and protect my confidence is a lifelong struggle because the markets are not a place that encourages confidence. You must look to simplify and focus on your methods to keep this balance.

If you are going to start putting the ideas, set-ups, and tools I have taught here to work, the first step is to examine what your situation is. Are you a short-funded trader? Will you only have 30 or 60 minutes to dedicate to finding trading opportunities? Will you perhaps have two to four hours (my typical day) to dedicate to the markets? Will you prefer options? Will you prefer to trade on very short time frames like a 15-minute? Will you prefer to trade on the daily exclusively (which I did for the first few years I was learning to trade... this was long before the Internet)? Be honest. Don't idealize. My goal is for you to make each minute count. More time is not necessarily better. In fact I believe in Parkinson's Law:

*Work expands so as to fill the time available for its completion.*

So, do not worry if your time is short, or if you can't be a full-time trader. By the way, to me, the term "full-time trader" means that trading is the primary income source. It should not be defined by time, but more importantly, it should be defined by results. Your goal should include being a full-time trader with part-time hours!



## Very Special Offers for Book Buyers

Over the years Raghee Members have been treated to invitations to see her in person at guest lectures across the United States and abroad, and to free trials of automated software, charting, and the latest in market technology, as well as unprecedented access to Raghee herself.

As a **Master Member**, available *free* only to those special traders who buy and read her books, you will receive discounts on educational Video Packages and have access to a *very special* 10-installment online video course just for you, her Master Member. You will have access to your own page with videos, charting analysis, and special offers and all this is at **no charge** now or in the future. This is just one way we at Raghee.com take care of our traders and Raghee's students. All you need to do is register at the special link we have set-up for you—your passport to your Master membership at Raghee.com: [www.raghee.com/mastermember.htm](http://www.raghee.com/mastermember.htm).

Register now for:

- Ten online installments of **Learn to Trade Forex**
- Recordings of **Raghee's Morning Classroom**
- Free demo **trading accounts** featuring either Forex Trader Platform or MT4 Platform
- E-mail notifications of live online seminars with Raghee Horner
- Buy Raghee's Bestselling **Video Intro Package** at 85 percent off the regular price. Just enter **forex5** Coupon Code at check-out [www.raghee.com](http://www.raghee.com).

These offers are subject to change without notice.



# Index

- Accumulation market cycles, 24,  
58–59, 125, 139
- Actionable analysis, 145
- Aggressive (aggro) trades, 71
- Alert candle, 48
- Asian markets, 96
- Asian trading opening, 76
- Asian trends, 86
- Ask, 90–91
- AUD/USD (aussie), 11, 77, 86, 104  
commodity currencies (comm  
dolls), 109, 110  
gold, 111  
market cycles, 26–28  
market pulse, 110–115  
and NZD/USD (kiwi), 111  
precious metals, 110
- Australia, 75
- Autochartist (charting software), 41,  
144, 166, 171–172
- Autochartist (charting software  
website), 180
- Autochartist PowerStats (charting  
software), 81
- Automation:  
about, 163–165  
charting tools, 165–166  
fifteen-minute set-ups, 170–177  
profit targets, 166–170
- Auto scaling, 30
- Average pip movement, 181
- Baby Pips (website), 180
- Baking into the cake (discounting), 32,  
59, 115, 150
- Balance, 119–120
- Balanced market, 125
- Bank holidays, 86
- Bank rates, 165
- Bank spread, 165
- Base currency, 26
- Bear flags angle, 172, 175
- Bid, 90
- Bid/ask spread, 91, 129
- Bloomberg's currencies, 180
- Blue candles, 48
- BOE (Bank of England), 79
- BOJ (Bank of Japan), 79, 106
- Bounce, 66
- Bracketing, 63
- Breakeven exits, 160
- Breakeven stops, 36, 37
- Breakouts, 59, 172
- Broker role:  
2 percent guidelines, 155–156  
about, 153–155  
stop loss placement, 156–158  
trading truths, 158–162  
triage, 158
- Bull flags angle, 172
- Bull markets, 3
- Buyers line, 6
- Buying and shorting trading  
technique, 4
- cable. *See* GBP/USD (cable)
- canada. *See* USD/CAD (loonie or  
canada)
- Canada and crude oil, 104
- Canadian dollar, 4

- Candles:  
     colored, 48  
     as fear and greed, 118  
 Canned trading, 34  
 Carry trade, 107  
 CCI (Commodity Channel Index)  
     confirmation. *See* Wave/CCI setup  
 Central bank rates, 112  
 Century numbers, 128  
 Challenges and rewards, 10  
 Charting analysis, 137  
 Charting platforms, 22  
 Charting software, 41  
 Charting tools, 166  
 Chartists vs. technicians, 138  
 Chart junkies, 12–14  
 Chart patterns, 139  
 Chasing the trend reaction, 67  
 China, 86  
 Clearing high, 80  
 Clearing levels, 80  
 Clearing low, 80  
 Clearing period, 80  
 Clock angle, 139  
 Closing time, 134  
 Colored candles, 48  
 Commodity currencies (comm dolls),  
     2, 3, 103, 169  
 Composite data, 21  
 Comprehension, 122  
 Comprehension, confirmation and  
     confidence (three Cs). *See* three  
     Cs  
 Confidence, 121–122, 124, 138  
 Confirmation, 123  
 Confirmation indicator, 72  
 Consensus numbers, 79  
 Consolidation patterns, 143  
 Consumer confidence, 145–146  
 Consumer psychology, 146  
 Continuous Commodity Index, 28, 108,  
     109  
 Corrections, 64, 66  
 Correlations, 101  
 Cost per trade, 17, 90  
 Cross rates, 76–77, 88  
 Crude oil, 3, 104–106, 170  
 Currency as stock of a country, 79  
 Cutting losses, 120–121  
 Cutting winners short, 120  
 Cycles, 23–24. *See also* market cycles  
 Daily charts, 90, 139  
 Daily Motion (website), 180  
 Daily time frame, 18, 111  
 Darts, 68  
 Data providers, 21  
 Decade numbers, 128  
 Decision levels, 15, 132  
 Demo trading, 123  
 Discounting process. *See* baking into  
     the cake (discounting):  
 Discovery of Lazy Day Lines, 45–46  
 Distribution market cycles, 24–25, 71,  
     125, 139  
 Dollar peg, 86  
 Double bottoms/tops patterns, 162  
 Double-zero numbers, 132  
 Dow, Charles, 23  
 Dow 1-2-3 pattern, 68, 136, 162  
 Dow Jones Industrial Average, 106, 107  
 Down channels pattern, 139, 142  
 Downtrending patterns, 140  
 Downtrend lines, 59  
 Downtrends, 26, 175  
 Dow Reversal pattern, 136  
 Dynamic support and resistance, 22  
 Eastern Standard Time (EST), 134  
 ECB (European Central Bank), 79  
 Economic calendar, 179  
 Economic event, 87  
 Economic releases, 60  
 Ego, 119  
 Emotions, 118  
 End of day charts, 139  
 Entries and exits, 128–129  
 Entry price, 59, 68  
 Entry style by market cycle, 159, 162  
 Entry triggers, 59, 62  
 Equities volatility, 107  
 eSignal, 21, 49, 166, 180

- EUR/CHF (euro-swissy), 91
- EUR/JPY (euro-yen), 88
- Euro, 77. *See also* EUR/USD (fiber)
- EUR/USD (fiber), 4, 11, 77
  - market cycles, 27
  - timing, 82–85
  - and U.S. Dollar Index, 98–99
- Even numbers, 128
- Exchanges, 21–22
- Execution price, 22
- Exit types, 160
- Exponential moving average (EMA), 21
- External market psychology, 118
- External psychology, 70, 120, 124
- EZ2Trade (charting software), 41, 49
- Failed trades, 68
- Falling wedges pattern, 140, 141
- Fear and greed, 37, 45, 118, 133, 139, 162
- Fed Funds Futures contract, 112
- Fed Funds rate, 112
- Fibo levels, 52
- Fibonacci analysis, 44–45
- Fibonacci-based exponential moving averages, 46, 139. *See also* Wave
- Fibonacci levels, 67
- Fibonacci numbers, 19–20
- Fibonacci Retracement and/or Extensions trading tool, 20
- Fifteen-minute set-ups, 170–177
- 52 Week highs and lows, 135–136
- Filling trades, 61
- Filtering tools, 61–62
- Financial centers, 11, 75–76
- Fixed-pip percentage, 38
- Flight to safety, 108
- Floors and ceilings identification, 147
- Follow-through, 61–62
- FOMC rate decisions, 84
- Forex Factory (website), 179–180
- Forex on the Go application, 180
- Forex options, 181
- Forex pairs, 26
- Forex Trader Daily (website), 181
- Four to six o'clock Wave angle (downtrend), 25, 26, 140, 172
- Frankfurt, 11, 76, 88
- Freakonomics blog, 181
- Full-time trading, 163
- Fundamental analysis, 32
- Fundamentals, 145
- Futures feed, 98
- FXStreet (website), 181
- GBP/JPY (twisted sister), 82, 91, 93
- GBP/USD (cable), 11, 77
  - market cycles, 27
  - and U.S. Dollar Index, 101
- Going long, 161
- Gold:
  - AUD/USD (aussie), 111
  - vs. U.S. dollar, 108, 109
- GRaB charts, 48, 146, 166
- Greed, 122. *See also* fear and greed
- Greenback, 77
- Green candles, 48
- Greenwich Mean Time (GMT), 76, 134
- Hedge funds, 164
- Herd movement, 124, 133
- Highs and lows. *See* touchpoints
- Holidays, 86
- Hong Kong, 11, 76
- Horizontal support and resistance, 59
- Hot zone, 87
- Human psychology, 120
- Illiquidity, 78
- Imbalanced market, 125
- Imbalance psychology, 64
- Impulsive entries, 161
- Indicator overlap, 62
- Indicators, 19–20, 61
- Inner psychology, 121
- Inside price, 22
- Insiders, 65
- Inside the range trading, 71–72
- Internal psychology, 118, 120, 124
- International calendars, 79
- Intraday time frames, 17



- Inverse correlation, 99
- Investing vs. trading, 3–4
- iPhone, 179, 180
- Japan, 106
- Japanese economic events, 89
- JSE website, 181
- Kirk, Charles, 180
- Kirk Report, 180
- Late comers, 65
- Latecomers, 65
- Lazy Day Lines, 166
  - about, 44
  - discovery of, 45–46
  - Fibonacci analysis, 44–45
  - real-life, 54–56
  - three C's, 55–56
  - use of, 46–48
  - Wave in action, 48–53
- Lazy Day Lines (charting software), 41
- Leading indicators, 162
- Learning curve, 137
- Lifehacker (website), 181
- Limit orders, 39
- Limits orders, 35–36
- Liquidity, 76
- Liquid pairs, 78
- London, 11, 80, 87
- Longer-term charts, 90
- Loonie, 77. *See also* Canadian dollar; USD/CAD (loonie or canada)
- Loser behavior, 15
- Lot size, 123
- MacBook, 179
- MACD histogram, 55, 61, 62–63, 71
- Major psychological numbers, 133
- Major trendlines, 42
- Manual analysis, 122–123
- Mark down market cycles, 26, 139
- Market analysis, 14–15
- Market contractions, 120
- Market cycles, 125
  - accumulation, 24
  - current, 139
  - distribution, 24–25
  - identification of, 33
  - importance of trading focus on, 159
  - knowledge of, 57–58
  - mark downs, 26
  - mark up, 25–26
  - meanings of, 28
  - transitions, 25
  - with the Wave, 123
  - Wave for determination of, 159
- Market cycle strategies:
  - inside the range trading, 71–72
  - momentum trading (momo), 58–63
  - short cycle setups, 68–71
  - swing trading, 63–68
- Market cycle tools, 22
- Market direction, 17, 139
- Market makers, 165
- Market memory, 28–30
- Market movement, 13–14, 58
- Market orders, 35, 40, 161
- Market overlap, 76
- Market psychology, 15, 69–70
- Market pulse:
  - about, 97–104
  - AUD/USD (aussie), 110–115
  - USD/CAD (loonie or canada), 104–109
  - U.S. dollar Index, 110–115
- Market pulse chart, 98
- Market volatility, 170. *See also* volatility
- Mark up market cycles, 25–26, 139
- Meanings of market cycles, 28
- Mechanical systems, 164–165
- Meet Pips (website), 180
- Metatrader 4 (MT4) (charting software), 21, 41, 61, 166, 180
- Micro lots, 123, 166
- Mini lots, 123, 166
- Minor psychological numbers, 133
- Minor trendlines, 42
- Mistakes, common, 15
- Momentum entries, 171
- Momentum trading (momo), 55, 58–63

- Morning pivots, 80
- M or W patterns, 68
- MT4. *See* Metatrader 4 (MT4) (charting software):
- Multiple lots, 37
- Multiple time frame (MTF)
  - confirmation, 17
- National holidays, 86
- Neutral candles, 48
- News releases, 127
- New York, 11, 76, 78
- Nicknames, 77
- Nontrending patterns vs. trending patterns, 140
- NZD/USD (kiwi), 86–87, 104, 108–109, 111
- Objectivity:
  - about, 33–34
  - order entry, 35–36
  - risk management, 38–41
  - static and dynamic lines, 41–42
  - stop loss, 36–38
  - support and resistance, 41–42
  - trendlines, 41–42
- One mind many markets philosophy, 94
- Open and closing times, 66
- Opening, 75–76
- Opening range, 80–81
- Opening range play (set-up), 81, 85
- Order entry, 32, 35–36, 60
- Order execution, 60
- Order flow, 6
- Oscillators, 72
- Parity, 132
- Parked profit target orders, 40
- Participation levels, 128–129
- Pattern Radar (website), 181
- Patterns within patterns, 68
- Pending orders, 36
- Perceived risk, 119
- Percentage levels, 67
- Perception of value, 133
- Pig in the head problem, 34, 40
- Pip movement, 81–82
- Pip movement range, 85
- Pip range, 91–92
- Pips, 38
- Pivot points, 66
- Point of validity (POV), 156, 157
- Pound sterling, 77
- PowerStats Basic (software), 81, 180–181
- PowerStats pip movement range, 84
- Precious metals:
  - AUD/USD (aussie), 111
  - vs. continuous commodity index, 108
  - flight to safety, 108
- Preconfirmed indicators, 61
- Price:
  - basic ideas of, 139
  - and price action, 127–128
- Price action, 15, 127
- Price action trading, 161–162
- Price psychology, 154
- Prices respecting the levels, 47
- Primary charts, 98
- Prime time, 11, 76–81
- Proactive orders, 61
- Profit target orders, 39
- Profit targets, 36–37, 39, 166–170
- Pro Real Time (software), 180
- Protective stop loss, 36
- Psychological levels, 29–30, 39, 59, 133
- Psychological numbers, 39, 131–136
  - 52 week highs and lows, 135–136
  - 200 SMA, 133–134
  - about, 131–132
  - using the herd, 133
- Psychology of balance, 125
- Psychology of news, 125–127
- Psychology of numbers, 128–129
- Psychology of time, 127–128
- Psychology of trends, 64
- Pullbacks, 66
- Quality of trades, 63
- Quantifiable risk, 119

- Quick-transition trading, 69
- Quid, 77
- Quote.com, 180
- Range bounce market confirmation indicators, 72
- Range-bound (sideways) market, 58, 125, 127, 144
- Ratcheting stops, 160
- Real-life Lazy Day Lines, 54–56
- Real-time feeds, 98
- Real-time trend identification, 23
- Recommendations, 179–181
- Rectangles (consolidation pattern), 143
- Red candles, 48
- Resistance level numbers, 129
- Retracement levels, 67
- Reversal play, 178
- Reversal signals, 106
- Reversions vs. corrections, 65
- Right side of the chart, 145–146
- Rising wedges pattern, 140, 167, 175
- Risk appetite, 148
- Risk aversion, 107, 119–120
- Risk-based exits, 160
- Risk management, 38–41, 156, 157
- Risk tolerance, 17
- Risk-to-reward ratio, 38
- Role of experience, 120–123
- Running stops, 154
- Safe-haven currency, 105
- Scared money, 122
- Schabacker, Richard, 23, 138
- Scheduled events, 79
- Secondary correlation charts, 98
- Second currency, 26
- Sellers line, 6
- Selling the news, 148, 150, 152
- “Set it and forget” order entry habit, 40
- Set-up, 133
- Set-up comparison, 158
- Shift points, 62
- Short cycle setups, 68–71
- Shorting, 4–7
- Sideways market. *See* range-bound (sideways) market:
- Sideways market cycle, 143
- Simple moving average (SMA), 20, 61
- Singapore, 11, 76
- 60 Second stops, 63, 154
- Small Order Execution System (SOES) bandits, 164
- Soft levels, 71
- Solid ceiling or floor, 71
- Speculators, 65
- Spread, 90–91
- Spread and liquidity, 78
- Static and dynamic lines, 41–42
- Static levels (ceilings), 166
- Stop loss, 36–38, 119
  - formula based, 155
  - validity based, 69
- Stop loss placement, 156–158, 160
- Stop loss targets, 36
- Stop order placement, 160
- Stop orders, 36
- Stop orders (or better orders), 39
- Stop placement, 94
- Strategy failures, 124–125
- Subjective analysis, 33–34
- Support and resistance, 28, 36, 41
- Support level numbers, 128
- Support trend zero-ending numbers as, 132
- Surprise and volatility, 126
- Swing entries, 171
- Swing trading, 63–68
- Sydney, 11, 76
- Symmetrical triangle pattern, 148
- Technical Analysis and Stock Market Profits* (Schabacker), 138
- Technicians vs. chartists, 139
- Three Cs, 55–56, 121–122, 123–124, 138
- Three o'clock Wave angle (accumulation), 22, 24–25, 62
- Time-based stop, 63
- Time-based strategy, 79–80
- Time frame memory, 29–30
- Time frames, 16–18

- Time frame selection, 171
- Timing effects, 85–95
- Tokyo, 11, 76
- Top and bottom picking, 67, 136, 162
- Touchpoints, 42, 67, 71, 121
- Trade positions, 118
- Trades gone bad, 160–161
- Trading:
  - full time vs. part time, 9
  - and gambling, 14–15
  - vs. investing, 3
- Trading day, 75
- Trading edge, 137–143
- Trading errors, 154–155
- Trading for real, 123–125
- Trading Markets (website), 181
- Trading news, 125–126
- Trading psychology:
  - about, 117–119
  - balance, 119–120
  - entries and exits, 128–129
  - market cycles, 125
  - psychology of news, 125–127
  - psychology of numbers, 128–129
  - psychology of time, 127–128
  - role of experience, 120–123
  - trading for real, 123–125
- Trading the news, 88
- Trading time, 74–75, 154
- Trading time choices, 95–96
- Trading truths
  - entry style by market cycle, 159, 160
  - going long, 161
  - impulsive entries, 161
  - leading indicators, 162
  - price action trading, 161–162
  - ratcheting stops, 160
  - stop order placement, 160
  - top and bottom picking, 162
  - trades gone bad, 160–161
- Trading with price, 31–32
- Trailing exits, 160
- Trailing stops, 37–38
- Transitions, 25
- Transparency, 165
- Trapani, Gina, 181
- Trend following, 121, 172, 176
- Trend identification, 16
- Trending markets, 63
- Trending patterns, 140, 178
- Trendlines, 41
- Trend reversal, 69, 175, 178
- Trends, 59, 125
- Trend trading, 66
- Triage, 54, 63, 158
- Triangle breakout pattern, 151, 156, 160
- Triangle pattern, 151
- Trichet, Jean-Claude (ECB President), 79
- Triple-zero numbers, 132
- Turning points, 162
- Twelve to two o'clock Wave angle (uptrend), 25, 26
- 24-hour Trading market, 74, 90
- Twisted sister, 82, 91, 93
- 2 Percent guidelines, 155–156, 157–158
- 200 SMA (simple moving average), 133–134
- Two o'clock Wave angle (weak uptrend), 22, 64, 66
- Two to four o'clock Wave angle (distribution), 25–26, 70
- United States, 75, 112
- Universal Coordinated Time (UCT).
  - See Greenwich Mean Time (GMT)
- Up channels pattern, 140
- Uptrending patterns, 140
- Uptrend lines, 59, 167
- Uptrends, 25–26
- USD/CAD (loonie or canada), 3, 4, 11, 77
  - and crude oil, 169
  - market cycles, 27
  - market pulse, 97–109
- USD/CHF (swissy), 11, 77, 90, 95
  - market cycles, 27–28
  - and U.S. Dollar Index, 102

- USD/JPY (dollar-yen), 11, 77, 86, 146, 147, 148
  - Dow Jones Industrial Average, 106, 107
  - market cycles, 27
  - and U.S. Dollar Index, 100
- U.S. dollar:
  - and commodities, 108–109
  - vs. continuous commodity index, 108
  - and crude oil, 104, 167, 169
  - flight to safety, 108
  - forecast of, 111–112
  - vs. gold, 108, 109
  - safe-haven currency, 105, 108
- U.S. dollar correlated majors, 1, 11
- U.S. Dollar Index, 98, 110–115, 150
  - and EUR/USD (fiber), 98–99
  - and GBP/USD (cable), 101
  - and USD/CHF (swissy), 102
  - and USD/JPY (dollar-yen), 100
- VM fusion (software), 179
- Volatility, 60, 85, 87, 94
  - of Asian markets, 96
  - based on holidays and major reports, 86
  - expected, 92
  - and short time frames, 128
  - and surprise, 127
- Wait and see attitude, 127
- Wave:
  - about, 19–22
  - as entry point, 66
  - market cycles, 23–28
  - market memory, 28–31
  - real-time identification of direction, 23
  - trading with price, 31–32
- Wave/CCI entry, 69
- Wave/CCI setup, 48, 70–71
- Wave in action, 48–53
- Wave positions, 64
- Wave reversal entry, 69
- Whole round numbers, 131
- Winner transactions, 36
- Working hours, 75
- World Tick Time Zone Clock (software), 75
- World trading:
  - about, 73–75
  - EUR/USD (fiber) timing, 82–85
  - financial centers, 75–76
  - pip movement, 81–82
  - prime time, 76–81
  - timing effects, 85–95
  - trading time choices, 95–96
  - working hours, 74–75
- World view, 90
- Yuan trading, 86
- Zen Habits (website), 181
- Zero-ending numbers as support trend, 132

*Praise for*  
**FOREX ON FIVE HOURS A WEEK**

“The style allows Raghee Horner to tackle the thorniest concept for beginning traders to understand from the outset—shorting. The explanation is one that is the best I’ve read in many a book, all because she is conversing with you within the pages.”

—KIARA ASHANTI, *ACTIVE TRADER MAGAZINE*

“Just who is Raghee Horner? That’s easy. If you are a forex trader, Raghee Horner is a young woman who can change your life. She can turn your losses into profits. She can take the mystery out of trading this incredible market.”

—PETER McKENNA, *INVESTOR’S BUSINESS DAILY*

---

PAKISTAN VIRTUAL LIBRARY  
[www.pdfbooksfree.pk](http://www.pdfbooksfree.pk)

Trading the forex market has become one of the most popular forms of trading. It’s a 24/7 job for many. But what if you have a day job and only a little time to dedicate to the market?

In *Forex on Five Hours a Week*, top forex trader Raghee Horner shows you how, with a few key techniques and just five hours a week, you can capture consistent profits in the forex market.

